Introduction to Financial Accounting

(As per the Revised Syllabus 2014-15 of 'University of Mumbai' for F.Y. BMS (Introduction to Financial Accounts) and F.Y. B.Com. (Economics & Environment Management) Semester I)

Winner of "*Best Commerce Author 2013-14*" *B*y Maharashtra Commerce Association

Dr. Nisikant Jha

ICWA, M.Com., Ph.D., PGDBM (MBA), BEC from Cambridge University
CIMA Advocate, CIMA London
International Executive MBA from UBI Brussels, Belgium, Europe
Assistant Professor in Accounts & Coordinator (HOD) BAF,
Thakur College of Science and Commerce,
UGC Recognised, University of Mumbai.
Visiting Faculty for: M. Phil. & M. Com. Hinduja College Mumbai University,
MBA in United Business Institutes, Brussels, Belgium, Europe,
CFA & CFP Professional Courses of USA, CIMA Professional Courses of London,
CA & CS Professional Courses of India, M. Phil. & Ph.D. Guide [Research Supervisor]
& Professor for Research Methodology

Prof. Nimesh Jotaniya

PGDFM, M.Com., UGC-NET
Assistant Professor in Accounts at
Thakur College of Science & Commerce.

Dr. Arvind Luhar

M.Com, MBA, NET, Ph.D.
HOD, I.Y. College.

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Nagpur : Kundanlal Chandak Industrial Estate, Ghat Road, Nagpur - 440 018. Phone: 0712-2738731, 3296733; Telefax: 0712-2721216

Bengaluru : No. 16/1 (Old 12/1), 1st Floor, Next to Hotel Highlands, Madhava Nagar, Race Course Road, Bengaluru - 560 001. Phone: 080-22286611, 22385461, 4113 8821, 22281541

Hyderabad : No. 3-4-184, Lingampally, Besides Raghavendra Swamy Matham, Kachiguda, Hyderabad - 500 027. Phone: 040-27560041, 27550139

Chennai : 8/2 Madley 2nd street, T. Nagar, Chennai - 600 017. Mobile: 09320490962

Pune : First Floor, "Laksha" Apartment, No. 527, Mehunpura, Shaniwarpeth (Near Prabhat Theatre), Pune - 411 030. Phone: 020-24496323/24496333; Mobile: 09370579333

Lucknow : House No 731, Shekhupura Colony, Near B.D. Convent School, Aliganj, Lucknow - 226 022. Phone: 0522-4012353; Mobile: 09307501549

Ahmedabad : 114, "SHAIL", 1st Floor, Opp. Madhu Sudan House, C.G. Road, Navrang Pura, Ahmedabad - 380 009. Phone: 079-26560126; Mobile: 09377088847

Ernakulam : 39/176 (New No: 60/251) 1st Floor, Karikkamuri Road, Ernakulam, Kochi – 682011. Phone: 0484-2378012, 2378016; Mobile: 09387122121

Bhubaneswar : 5 Station Square, Bhubaneswar - 751 001 (Odisha). Phone: 0674-2532129, Mobile: 09338746007

Indore : Kesardeep Avenue Extension, 73, Narayan Bagh, Flat No. 302, IIIrd Floor, Near Humpty Dumpty School, Indore - 452 007 (M.P.). Mobile: 09303399304

Kolkata : 108/4, Beliaghata Main Road, Near ID Hospital, Opp. SBI Bank, Kolkata - 700 010, Phone: 033-32449649, Mobile: 7439040301

Guwahati : House No. 15, Behind Pragjyotish College, Near Sharma Printing Press, P.O. Bharalumukh, Guwahati - 781009, (Assam). Mobile: 09883055590, 08486355289, 7439040301

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Preface

It is a matter of great pleasure to present this new edition of the book on ***Introduction to Financial Accounting*** to the Students and Teachers of Bachelor of Management and Studies started by University of Mumbai. This book is written on lines of syllabus instituted by the university. The book presents the subject matter in a simple and convincing language.

We owe a great many thanks to a great many people who helped and supported us during the writing of this book which includes Principal, Co-coordinator, and Students of BMS Section.

The syllabus contains a list of the topics covered in each chapter which will avoid the controversies regarding the exact scope of the syllabus. The text follows the term-wise, chapter-topic pattern as prescribed in the syllabus. We have preferred to give the text of the section and rules as it is and thereafter added the comments with the intention of explaining the subject to the students in a simplified language. While making an attempt to explain in a simplified language, any mistake of interpretation might have crept in.

This book is an unique presentation of subject matter in an orderly manner. This is a student-friendly book and tutor at home. We hope the teaching faculty and the student community will find this book of great use.

We are extremely grateful to Mr. Pandey of Himalaya Publishing House Pvt. Ltd. for their devoted and untiring personal attention accorded by them to this publication.

We gratefully acknowledge and express our sincere thanks to the following people without whose inspiration, support, constructive suggestions of this book would not have been possible.

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Mrs. Anita Ninesh Jotaniya

Mr. Kalpesh Jotaniya & **Mrs. Anita K. Jotaniya**

Mr. Pritesh Gangar & **Mr. Alpesh Gangar**

Mr. Kalpesh Tank & **Mr. Rahul Tank**

Where we stand today is because of our revered parents whom we owe much.

We welcome suggestions from students and teachers for further improvement of quality of the book.

Authors

Our Well-wishers .....

1. Dr. A.C. Vanjani (Principal, MMK College)
2. Dr. Jayant Apte (Vice-Principal, G.D. Saraf College)
3. Mr. Vinod D. Tibrewala (Trustee, SRSS College)
4. Mr. Rajubhai Desai (Trustee, St. Rock's College)
5. Dr. S.B. Arya (Principal, KG Mittal College)
6. Dr. V.S. Kannan (Vice-Principal, KES College)
7. Prof. Baibhav (BAF Coordinator, KES College)
8. Prof. Kavita Shah (BMS/BAF/BBI Coordinator, NK College)
9. Dr. Ajay Bhamre (Principal, DAV College)
10. Dr. Malini Johri (Principal, Chinai College)
11. Dr. Chitra Natrajan (Principal, Hinduja College)
12. Dr. Minu Madlani (Principal, Adlani College)
13. Prof. Smita Shukla & Prof. Sanjeev Thakur (Alkesh Dinesh Modi Institute)
14. Prof. Bysi Panikar (BMS Coordinator, Patuk College)
15. Prof. Shirley Pillai (BBI Coordinator, St. Andrew's College)
16. Prof. Piyush Shah (Vice-Principal, Burhani College)
17. Prof. Prachi Kadam (BMS Coordinator, Gokhale College)
18. Prof. Monica Chandiwala (BMS/BAF Coordinator, Balbharti College)
19. Prof. Poonam Kakkad (BMS/BAF Coordinator, Nirmala College)
20. Dr. Sharda S.C. (Principal, L.N. College)
21. Prof. Tiwari (BMS Coordinator, Birla College)
22. Prof. Nanda (BMS Coordinator, SRSS College)
23. Dr. Shreepad Joshi (G.D. Saraf College)
24. Prof. Arvind Dhond (St. Xavier's College)
25. Prof. Rupal Shah (N.M. College)
26. Prof. Khayti Vohra (BFM Coordinator, Hinduja College)
27. Prof. Leena Nair (Tolani College)
28. Dr. Vinita Pimple (Poddar College)
29. Prof. Darshan Pagdhre (Lala College)
30. Mrs. Darshita N. Goda

Syllabus

F.Y. BMS (INTRODUCTION TO FINANCIAL ACCOUNTS)

Unit – 1

Meaning and Scope of Accounting: Need and Development, definition: Book-keeping and Accounting, Persons Interested in Accounting, Branches of Accounting, Objectives of Accounting.

Accounting Principles: Introduction to Concepts and Conventions.

Introduction to Accounting Standards (Meaning and Scope):

- **AS-1:** Disclosure to Accounting Policies
- **AS-6:** Depreciation Accounting.
- **AS-9:** Revenue Recognition.
- **AS-10:** Accounting for Fixed Assets.

International Financial Reporting Standards (IFRS):

- Introduction to IFRS
- **IAS-1:** Presentation of Financial Statements (Introductory Knowledge)
- **IAS-2:** Inventories (Introductory Knowledge)

Accounting in Computerized Environment: Introduction, Features and Application in Various Areas of Accounting

Unit – 2

- **Accounting Transactions:** Accounting Cycle, Journal, Journal Proper, Opening and Closing Entries, Relationship between Journal and Ledger: Rules Regarding Posting: Trial Balance: Subsidiary Books (Purchase, Purchase Returns, Sales, Sales Returns and Cash Book – Triple Column), Bank Reconciliation Statement.
- **Expenditure:** Classification of Expenditure – Capital, Revenue and Deferred Revenue expenditure, Distinction between capital expenditure and revenue expenses.
- **Unusual Expenses:** Effects of Error: Criteria Test.
- **Receipts:** Capital Receipt, Revenue Receipt, Distinction between Capital Receipts and Revenue Receipts.
- **Profit or Loss:** Revenue Profit or Loss, Capital Profit or Loss.

Unit – 3

- **Depreciation Accounting:** Practical Problems based on Depreciation using SLM and RBM methods. (Where Provision for Depreciation Account Not Maintained.)
- **Preparation of Trial Balance:** Introduction and Preparation of Trial Balance.

Unit – 4

Final Accounts of a Sole Proprietor:

- Introduction to Final Accounts of a Sole Proprietor.
- Rectification of Errors.
- Manufacturing Account, Trading Account, Profit and Loss Account and Balance Sheet.
- Preparation and Presentation of Final Accounts in Horizontal Format.
- Introduction to Schedule 6of Companies Act, 1956.

Syllabus

F.Y. B.COM. (ECONOMICS & ENVIRONMENT MANAGEMENT)

Unit – I

A. Meaning and Scope of Accounting: Need, Development and Definition; Book-keeping and Accounting; Persons Interested in Accounting; Disclosures; Branches of Accounting; Objectives of Accounting.

B. Accounting Transactions: Accounting Cycle, Journal, Journal Proper, Opening and Closing Entries, Relationship between Journal and Ledger; Rules regarding Posting; Trial Balance; Subsidiary Books; Bank Reconciliation Statement.

C. Accounting Standards

AS-1: Disclosures of Accounting Policies: Meaning of Accounting Policies; Purpose; Different Policies; Areas of Policies; Disclosure of Policies; Disclosure of Change in Policies; Simple Illustrations.

AS-6: Depreciation Accounting: Meaning; Definitions; Importance; Factors; Useful Life of a Depreciable Asset; Estimating Useful Life; Additions; Residual Value Methods; Disclosure of Surplus Change in Method; Simple Illustrations.

AS-9: Revenue Recognition: Meaning and Scope; Transactions Excluded; Sale of Goods; Rendering of Services; Effect of Uncertainties; Disclosure; Simple Illustrations.

AS-10: Accounting for Fixed Assets: Meaning; Definitions; Importance; Cost of Fixed Assets; Self-constructed Fixed Assets; Non-monetary Consideration; Improvements; Repairs, Additions and Extensions; Revaluation; Sale or Retirement; Valuation of Fixed Assets in Special Cases; Special Types of Fixed Assets; Disclosure.

Unit – II

1. Expenditure: Classification of Expenditure Capital, Revenue and Deferred Revenue Expenditure: Distinction between Capital Expenditure and Revenue Expenses; Unusual Expenses; Effect of Error; Critical Tests.

2. Receipts: Capital Receipt, Revenue Receipt, Distinction between Capital Receipts and Revenue Receipts.

3. Profit or Loss: Revenue Profit or Loss, Capital Profit or Loss.

B. Depreciation Accounting: Practical Problems Based on Accounting Treatment by Provision for Depreciation using SLM and RBM Methods.

Unit – III

Trial Balance and Final Accounts of a Sole Proprietor: Introduction to Trial Balance and Final Accounts of a Sole Proprietor; Rectification of Errors; Preparation and Presentation of Final Accounts in Horizontal Form; Manufacturing Account; Trading Account; Profit and Loss Account; Balance Sheet.

Unit – IV

Accounting in Computerized Environment: An Overview of Computerized Environment; Features of Computerized Accounting System; Concept of Grouping of Accounts; Codification of Accounts; Maintaining the Hierarchy and Ledgers; Accounting Packages and Consideration of them in Selection.

Paper Pattern

Question Paper Pattern

Maximum Marks: 75
Question to be Set: 05
Duration: $2\frac{1}{2}$ Hrs.
All Questions are Compulsory Carrying 15 Marks each.

Q. 1	Objective Questions A. Sub-questions to be asked 10 and to be answered any 08 B. Sub-questions to be asked 10 and to be answered any 07 (* Multiple choice/True or False/Match the columns, Fill in the blanks)	15 Marks
Q. 2 Q. 2	Full Length Practical Question Or Full Length Practical Question	15 Marks 15 Marks
Q. 3 Q. 3	Full Length Practical Question Or Full Length Practical Question	15 Marks 15 Marks
Q. 4 Q. 4	Full Length Practical Question Or Full Length Practical Question	15 Marks 15 Marks
Q. 5	A. Theory Questions B. Theory Questions OR Short Notes To be asked 05 To be answered 03	08 Marks 07 Marks 15 Marks

Note: Full length question of 15 marks may be divided into two sub-questions of 08 and 07 marks.

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1

CHAPTER

Meaning and Scope of Accounting

INTRODUCTION

All of you at one point of time would have visited a grocery shop or a medical shop. You might have wondered how the business person maintains the record of all the transactions done during a particular period of time say a year. You might have also thought why he or she has to maintain a record, how is it beneficial and whether it is mandatory or not? As against this, imagine the role of a business organization. They provide goods that might range from simple safety pin to fighter air crafts. Those who are in service industry provide various services such as transportation services, hospitality services, developing complex software programmes etc.

To make sound decision, a business enterprise need accounting information. This information is also needed by government agencies, regulatory bodies, analysts and individuals at various point of time and at different levels.

Accounting is perhaps one of the oldest and structured management information system. It has evolved in response to the social and economic needs of society. Accounting as an information system is concerned with identification, measurement and communication of economic information of an organization to its users who may need the information for rational decision making. The accounting system is a means to provide relevant and reliable financial information to all the interested parties.

Each and every person of the society is required to keep some accounts. In the stream of social and economic activities of today, each and every person or institution is accountable to someone or to other for his or its economic activities or the wealth acquired, income earned and the expenditure incurred. Different types of transactions occur in business. Without maintaining proper accounts, it is neither possible to ascertain profit or loss of the business nor to know the financial position of the business at any particular date. This chapter will describe meaning, evaluation, scope and objects of financial accounting. It also discusses importance and uses of accounting in daily life. Let’s go through the entire chapter and know introduction to financial accounting.

Definition of Accounting

Accounting is both the science and art of correctly recording in books of accounts all those business transactions that result in the transfer of money or money’s worth. It may also be defined as the art of recording mercantile transactions in a regular and systematic manner; the art of keeping accounts in such a manner that a man may ascertain correct result of his business activities at the end of a definite period and also can know the true state of affairs of his/her business and properties by an inspection of his/her books.

Accounting has been defined as, "the art of recording, classifying and summarizing in a significant manner in terms of money, transactions and events which are, in part at least, of financial character, and interpreting the results thereof." This definition has been given by the AICPA.

More Definitions of Accounting

American Accounting Association (AAA): AAA defines "Accounting refers to the process of identifying, measuring and communicating economic information to permit informed judgment and decisions by users of the information."

A.W. Johnson: "Accounting may be defined as the collection, compilation and systematic recording of business transactions in terms of money, the preparation of financial reports, the analysis and interpretation of these reports and the use of these reports for the information and guidance of management."

Weygandt, Kieso and Kimmel: "Accounting is an information system that identifies, records and communicates the economic events of an organization to interested users."

This definition views accounting as an information system that identifies and records the financial transactions, ascertains the results and provides information to the various interested users in the desirable way or according to their needs. Basically, accounting is not a recording procedure. It is an information device or a tool that works to provide information to interested users to rationalize their decision making.

SCOPE OF ACCOUNTING

The scope of field of accounting is very wide. Accounting is needed not only by business class but also by non-business class. Starting from the private life of a man, the financial activities of school, college, club, society, hospitals and government institutions come within the purview of accounting. The jurisdiction of accounting also includes the financial activities of professionals including doctors, engineers and layers. The monetary transactions which take place in the private life of a man are recorded properly in the books of accounts; it becomes possible to ascertain his receipts and expenditure as well as personal assets and properly in the books of accounts, it becomes to ascertain his receipts and expenditure as well as his personal assets and liabilities. When the financial transactions of a business are prepared, it is essential to maintain accounts of non-profit organizations like school, college, hospital, club, society etc. In the same way, it is necessary to keep accounts of professionals like service-holders, doctors, lawyers, actors/actress etc. to ascertain their incomes and calculation of income-tax on the basis of those incomes. Maintaining accounting is practiced to determine the income and expenditure of different government offices and public bodies as well as to run those offices and organizations properly. By preparing and evaluating national plan and budget with the help of accounting, it is possible to know the development and deterioration of the country. Hence, in a nutshell, we can say that the scope of accounting is wide enough to cover all the fields of the society.

Objectives of Accounting

The principal object of accounting is to keep permanent record of all monetary transactions effected by a person or enterprise during a definite period and ascertainment of results of those transactions at the end of the period. The main objects of accounting are enumerated below:

1. **Proper Recording of Transactions:** The first and foremost object of accounting is to keep record of monetary transactions in a systematic manner.

2. **Determination of Results:** Every person or institution is always interested to know the results of his/its monetary transactions at the end of a definite period. So, ascertainment of result of financial transactions is an important object of accounting.
3. **Ascertainment of Financial Position:** Another object of accounting is the ascertainment of debtors and creditors, assets and liabilities and the overall financial position.
4. **Supplying Financial Information:** Another important object of accounting is to make available all sorts of financial reports and statements to all parties interested in the affairs of the concerned institution as soon as possible after preparing those reports and statements.
5. **Defalcation Prevented:** Another special object of accounting is the prevention of defalcation of money made through fraud by the officials of the institution as well as control of expenditure.

NEED, IMPORTANCE AND USES OF ACCOUNTING IN DAILY LIFE

Accounting has become part of our daily activities as it implicates monetary transactions of life. People spend money, invest money for future; all these require proper accounting. Let's discuss the matter in detail.

Necessity and Importance of Accounting

The necessity and importance of accounting is limitless or unbounded to men in their day-to-day personal life, family life, and intuitional life. The necessity of accounting is described below:

Institutional Necessity

1. Accounting supplies numerical information to the institution relating to its management and administration.
2. Exact results of the institution are disclosed through accounting.
3. The firm can ascertain the financial status of the business operation.
4. Firm can compare the financial position of two/more years.
5. Books accounts are very valuable documents.
6. Proper accounting makes the firm credible to other party.
7. Tax authority can assess taxes for the firm using the accounting information.
8. Firm can determine the actual assets and liabilities.
9. Using accounting data, a firm can formulate policy and take many decisions on future operations.

Uses of Accounting in Day-to-day Life

1. Someone can ensure smooth financial management in his life.
2. He/she can bring financial solvency because financial plan helps to be economical.
3. Accounting helps in preparing personal budget.
4. Accounting promote saving habits.
5. Accounting helps to solve family and social disputes as it provides for authentic records.

ACCOUNTING: WHETHER SCIENCE OR ARTS?

There is a great controversy whether accounting is science or arts. According to some scholars, accounting is science, someone is describing accounting as arts. But actually accounting is a composition of both science and arts.

Why Accounting is 'Science'?

Science refers to systematic process. In scientific activities, it follows certain rules — observation, analysis, taking actions and then evaluation of activities. Like scientific activities before taking any action, accounting observes the activities, analyses the various alternatives, chooses the best alternatives and takes feedback to evaluate the performance. So, accounting is termed as science.

ACCOUNTING PROCESS

Accounting is the process of identifying the transactions and events, measuring the transactions and events in terms of money, recording them in a systematic manner in the books of accounts, classifying or grouping them and finally summarizing the transactions in a manner useful to the users of accounting information.

1. **Identifying the Transactions and Events:** This is the first step of accounting process. It identifies the transaction of financial character that is required to be recorded in the books of accounts. Transaction is transfer of money or goods or services from one person or account to another person or account. Events happen as a result of internal policies or external needs. Events of non-financial character cannot be recorded even though such events may have an impact on the operational results of the firm.
2. **Measuring:** This denotes expressing the value of business transactions and events in terms of money (in terms of rupees in India).
3. **Recording:** It deals with recording of identifiable and measurable transactions and events in a systematic manner in the books of original entry that are in accordance with the principles of accountancy.
4. **Classifying:** It deals with periodic grouping of transactions of similar nature that appear in the books of original entry into appropriate heads by posting or transfer entries. For example, all purchases of goods made for cash or on credit on different dates are brought to purchase account.
5. **Summarizing:** It deals with summarizing or condensing transactions in a manner useful to the users. This function involves the preparation of financial statements such as income statement, balance sheet, statement of changes in financial position and cash flow statement.
6. **Analyzing:** It deals with the establishment of relationship between the various items or group of items taken from income statement or balance sheet or both. Its purpose is to identify the financial strengths and weaknesses of the enterprise. The above six process in the present-day scenario are generally performed using software packages.
7. **Interpreting:** It deals with explaining the significance of those data in a manner that the end-users of the financial statement can make a meaningful judgment about the profitability and financial position of the business. The accountants should interpret the statement in a manner useful to the users, so as to enable the user to make reasoned decision out of the alternative course of action. They should explain various factors on what has happened, why it happened, and what is likely to happen under specific conditions.

8. **Communicating:** It deals with communicating the analyzed and interpreted data in the form of financial reports/statements to the users of financial information, *e.g.*, Profit and Loss account, Balance Sheet, Cash Flow and Funds Flow statement, Auditors Report etc. The Accounting Information system.

The Accounting Information System

Input	Processing
1. Business transaction 2. External events measured in financial terms 3. Law and regulation 4. Classification and interpretation	1. Accounting concepts, conventions and principles 2. Management plans and policies

Out put	Users
1. Profit and Loss A/c 2. Balance sheet 3. Cash flow statement 4. Explanatory notes 5. Audit report 6. Regulatory filing	1. Shareholders 2. Regulators 3. Lenders 4. Employees 5. Management 6. Rating agencies

LIMITATIONS OF ACCOUNTING

1. Though accounting system is the only source for extracting financial information of the firm, it grossly lacks qualitative elements. Qualitative resources could include leadership of top brass, highly talented human resource, highly motivated team, best products, the power of resource and development, brand image etc.
2. Accounting is not free from bias. The accountants have some leeway or freedom on the methods of depreciation charged, inventory valuation etc. Though the convention says consistency has to be maintained on the policies adopted, there is considerable room for bias, favourism and personal judgment.
3. Accounting reveals the estimated position and not the real position of the firm. Generally, financial statements are prepared on separate entity concept, conservatism concept etc. which are based on the estimates that may lead to overvaluation or undervaluation of assets and liabilities. The exact picture of the financial situation can be ascertained only on the liquidation of an enterprise.
4. Accounting ignores the price level changes when financial statements are prepared on historical cost. Fixed assets are shown in the balance sheet at historical cost less accumulated depreciation and not at their replacement value. Land value is shown at historical cost but the replacement value could be far higher than the value stated in the balance sheet due to appreciation of land value over the period of time.
5. The danger of window dressing arises when the management decides to incorporate wrong figures to artificially inflate revenue or deflate losses or when there is a threat of hostile takeover. In such a situation, the management fails to provide true and fair view of the financial position to the various users of the financial statement. Satyam Computer Services,

the fourth largest software firm, went into bust when the information on inflated income to the extent of ` 7,000 crore was revealed.

MEANING OF ACCOUNTING PRINCIPLES, CONCEPTS AND POLICIES

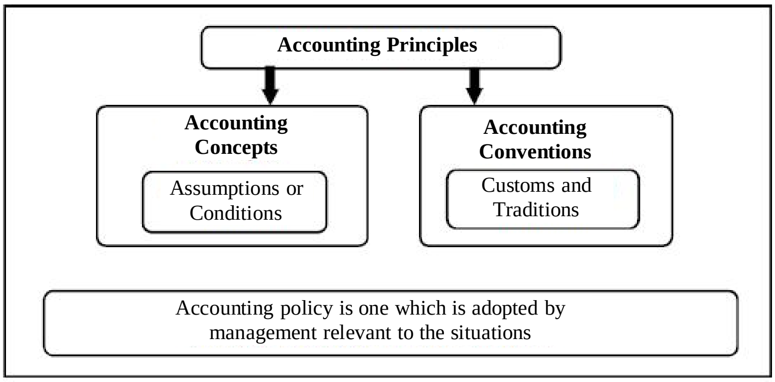
Accounting information is used by various stakeholders. Since all the stakeholders should understand the accounting language in the same sense, certain principles, concepts and policies of accounting have been laid down.

1. **Accounting Principles:** Accounting Principles are basically the rules of action adopted by the accountants universally while recording accounting transactions. The principles are doctrines associated with theory and procedures and current practices of accounting. These principles may be classified as concepts and conventions.

2. **Concepts:** Concepts take the form of assumptions or conditions, which guide the accountants while preparing accounting statements.

   Example: Business is started with an assumption that it shall be continued for a long period of time and none wishes it to close down within a short period of time.

   Based on this assumption, businessperson purchases fixed assets, uses long-term source to fund the fixed assets etc. This strong assumption that the business will continue for a long period of time is called a concept.



3. **Conventions:** Conventions are those customs and traditions which guide the accountants while preparing the financial statements.

   Example: Inventory (stock) in a business is valued at the end of an accounting period, at cost or market price whichever is lower. This is an accepted convention or a practice in accounting.

4. **Accounting Policy:** Accounting policy refers to the specific accounting principles and methods of applying those principles adopted by the enterprise in the preparation and presentation of financial statements.

   Example: While depreciating an asset, the practice of adopting straight line method or diminishing balance method or any other method is a convention.

The choice of selecting straight line method of depreciation or any other is the policy of the management. No management can exercise discretion regarding fundamental presumptions of accounting. But every management has a choice of making an accounting policy.

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES

The double entry system of accounting is based on a set of principles which are called generally accepted accounting principles. It incorporates the consensus at a particular time as to:

1. which economic resources and obligations should be recorded as assets and liabilities by financial accounting,
2. which changes in assets and liabilities should be recorded,
3. when these changes are to be recorded,
4. how the assets and liabilities and changes in them should be measured,
5. what information should be disclosed and
6. which financial statement should be prepared.

For example, an entity having research and development department may follow the policy of deducting all the R&D expenses incurred in a year as revenue expense while for the same situation another entity may classify R&D expenses into projects and may write off only when the project is not expected to offer any future benefits.

US GAAP	**Indian GAAP**
It is established under FASB and AICPA	It is established by ICAI
Balance sheet, Income statement and Fund flow statement are alone mandatory	Statement are mandatory
Any change in foreign exchange fluctuations cannot be capitalized but the difference can be shown or debited to income statement	Any difference in foreign exchange can be capitalized
Financial accounting, management accounting and income tax accounting are prepared separately	Only financial accounting and income tax accounting are prepared
The basic tenets is globalization of business	The basic tenet is localization
Any long-term loan repayable in the current financial year is shown separately	Long-term loan maturing in the current financial year need not be disclosed separately
In lease contract, lease is more beneficiary because he can claim depreciation allowance	In lease contract, lessor is eligible for depreciation allowance and not the lease
It is more transparent and accepted worldwide. More disclosure is required	It is comparatively less transparent. For listing the securities in other country's stock exchange US GAAP is mandatory

INTRODUCTION TO BOOK-KEEPING

Every business involves exchange of goods or services. That means a businessman or business concern deals with other parties in exchange of goods or services. Such dealings, in business, are called business transactions. The business transactions include purchase of goods or services, sale of goods or services, payments, receipts etc. In a business concern, the transactions are numerous. All the details of these varied transactions cannot be remembered by the businessman.

So, there was a need to record all business transaction in a systematic way and this job of recording of transactions have been later on called as *"Book-keeping"*.

Meaning of Book-keeping

Book-keeping is a process of recording business transactions in the books of accounts in a systematic manner.

Book-keeping is the process of analyzing, classifying and recording transactions in a systematic manner to provide information about the financial affairs of the business concern.

Book-keeping may be defined as the science and the art of the recording monetary, business transactions in a set of books.

'Book' means 'Book of Accounts' and 'keeping' means 'maintaining' the books of accounts. Thus, the writing of business transactions in the books of accounts for future use is a simple meaning of Book-keeping.

All the transactions are recorded date wise. *A person who records the same is called as an Accountant* who has to show the business results from such records at the end of financial year which ends on 31st March every year. In India this system of book-keeping was in operation from 23rd centuries ago at the time of Chandragupta Maurya. Chanakya was recording the accounting transactions. He wrote a famous book known as "Arthashashtra". After some years, this system was called as "Deshi Nama". The Double entry system of book-keeping was originated in Italy, developed by Luca De Bergo Pacioli in the year 1494.

Definitions of Book-keeping

R.N. Carter has defined, *"Book-keeping is the science and art of correctly recording in the books of accounts, all those business transactions that results in transfer of money's worth."*

J.R. Batliboi has defined, *"Book-keeping is the art of recording business dealings in a set of books."*

Book-keeping is a Science or an Art

Book-keeping is a science as well as an art. Book-keeping has some rules and principles as (like) science. Book-keeping is a systematic body of knowledge governed by certain rules. Therefore, it is called as science. However, it is not a physical, natural or pure science like chemistry, Biology or Mathematics, but a social science evolved by man and society. Therefore answers provided by Book-keeping are not always fixed or rigid, but largely dependent upon the needs of the business and the society.

An art means an action of doing a thing with some skill and experience. Therefore, Book-keeping is an art. An accountant (Book-keeper) can represent any typical transactions in an easy way with his art. In book-keeping some transactions can be represented in alternate (different) ways.

Features of Book-keeping:

1. It is the process of recording business transactions
2. It is an art of recording business transactions scientifically.
3. It needs documentary support for each transaction.
4. Transactions are recorded in specific set of books only.
5. It records only monetary transactions. Non-monetary transactions can not be recorded.
6. The system of recording should be universal.
7. The business organization records its own transactions with others.
8. Record is prepared for a specific period but presented for future references.

Objectives of Book-keeping:

1. To know the profit or loss of business during a particular (specific) period.
2. To know the financial position (assets and liabilities) of the business on a particular date.
3. To know the amount of capital invested in the business.
4. To have a systematic, permanent record of business transactions.
5. To know the amount due to business from various debtors.
6. To know the amount due to creditors from business (To know what the businessman owes to others and what others owes to him).
7. To know the amount of various taxes payable to the Government.
8. To provide valuable information for legal purposes.
9. To compare his business with that of other concerns engaged in a similar line.
10. To find out the total incomes and total expenditures of the business.
11. To know the goodwill of the business.
12. To know the progress of the business.
13. To know how the amount of profit or loss is made up.
14. To keep a check on the properties.
15. To review the progress of the business from year to year.
16. To prevent and minimize the accounting errors and frauds.
17. To know the total business purchases and sales.
18. To help in taking decisions on important business matters.

Importance of Book-keeping:

Following points explain the importance of Book-keeping.

1. **Aid to Memory:** Human memory has certain limitations. A businessman cannot remember all the business transactions. Book-keeping helps the businessman in this regard also. Due to book-keeping, it is not necessary to remember the transactions.
2. **Facilitates Planning:** Proprietors have to plan their business operations for years to come. Book-keeping generates valuable information about production, sales, expenses and incomes, which helps planning.
3. **Decision-making:** Management has to take valuable decisions about business. Book-keeping makes available necessary information, which facilitates decision-making.
4. **Controlling:** With the help of available financial information and figures, the executives of the business can control the business.
5. **Comparison:** A businessman can do yearly comparative study to understand the business position over the years. He can also do the comparative study with other business units.
6. **Helpful in Getting Discharge:** In case of insolvency of a proprietor, he can get discharge from the court on the basis of record of business transactions.
7. **Settlement of Tax Liability:** Book-keeping is useful to find out tax liability in case of Sales Tax, Income Tax, Property Tax etc. Proper record of transactions would enable a businessman to fix up the amount of his tax liability and discharge it.

8. **Protection against Theft and Dishonesty:** A businessman can protect himself against theft and dishonesty of employees by keeping books of accounts in a systematic manner. He can exercise greater control on his finance through systematic recording only.
9. **Evidence in Litigations:** Court considers the record provided by businessman as an evidence in case of any disputes.
10. **Sale of Business:** In case the business is sold out, the purchase consideration can be decided on the basis of the accounts maintained.
11. **Helpful in Getting Loans:** A businessman may require loans from banks for financing his expansion scheme. Properly kept accounts can convince the banks about financial soundness of business.

Utility of Book-keeping

1. **To Owner:** It helps to find out profit, losses, assets and liabilities in the business at any time.
2. **To Management:** It helps the management in planning, decision-making, controlling and managing the overall business activities.
3. **To Government:** Book-keeping helps various departments of government to decide how much taxes are collected from business.
4. **To Investors:** Investors can decide whether to invest or not to invest their funds in the business on the basis of information provided by the Book-keeping and Accountancy.
5. **To Customers:** Customers can judge the financial capacity of the business and can remain assured about smooth supply of goods.
6. **To Lenders:** Lenders can study the creditworthiness of the business firm with the help of books of accounts which assures continuous supply of funds.
7. **To Purchaser:** Book-keeping helps the purchaser to find out the true value of the business.
8. **To Trade Union:** Book-keeping helps the trade union to know that wages, salaries or bonus given to employees are fair or not. A trade union is able to demand high wage (Wage hike) on the basis of book-keeping.
9. **To Partner:** In case of partnership firm, partners are able to get information about admission, retirement or death of a partner from book-keeping.

Distinction between Book-keeping and Accountancy

	Book-keeping	**Accountancy**
1	**Meaning**	
	Book-keeping is a process of recording business transactions in the books of accounts in a systematic manner means of collecting and summarizing.	Accountancy is concerned with the processes of recording, sorting and summarizing data resulting from Business operations and events. Accountancy also refers to systematic analysis of the recorded data.
2	**Stage**	
	Book-keeping is the first stage and it comes immediately after transaction.	Accountancy comes after recording and classification. Accountancy is the next stage after Book-keeping.

3	**Objectives**	
	Book-keeping aims at keeping the record and provides primary information.	Accountancy aims at finding the profits or losses and gives financial position.
4	**Level of work**	
	In book-keeping, the level of work is less. It is done by junior staff.	In accountancy, the level of work is high. It is done by senior staff.
5	**Results**	
	Book-keeping basically results in Journal and Ledger.	The results of Accountancy is Profit and Loss A/c and Balance sheet.
6	**Period**	
	Book-keeping gives day to day details.	Accountancy gives details of entire year.
7	**Scope**	
	Book-keeping has a limited scope.	Accountancy has a wider scope.
8	**Procedure**	
	Book-keeping includes recording the entries of day-to-day transactions by following basic rules of double entry book-keeping system.	Accountancy includes processing of primary information available from books of accounts and preparation of financial statements.
9	**Principles**	
	Book-keeping requires principles of elementary knowledge of Journalizing and Posting.	Accountancy requires all the Accounting Principles.
10	**User**	
	Book-keeping records are used by accountant as it provides the basis for accountancy.	Accounting records are used by owners, managements, government and other stock holders.

Basis of Accountancy/Accounting

1. Cash Basis: Under this system, only cash transactions are recorded. Under cash basis, an income is recorded only when cash is actually received and expenses are recorded when cash in actually paid. The business records every cash that comes in business and every cash that goes from business.

2. Accrual Basis: An income is recorded when it is earned (whether cash received or not) and expenses is recorded when they become payable. Both cash as well as credit transactions are recorded. This is also called Mercantile Basis of Accounting.

Branches of Accounting

In order to satisfy the needs of different people interested in the accounting information, different branches of accounting have been developed. The changing business scenario has given birth to the specialized branches of accounting which are:

1. Financial Accounting: Financial Accounting is concerned with recording of financial transactions, summarizing and interpreting them and communicating the results. It is original form of accounting that ascertains profits earned or loss suffered during a specific period (generally a year) and ascertains the financial position on the date when the accounting period ends.

2. Cost Accounting: It is the process of accounting and controlling the cost of product, operation or function. The purpose of this branch of accounting is to ascertain the cost, to control the cost and to communicate information for decision.

3. Management Accounting: It is an accounting for the management, *i.e.*, accounting which provides necessary information to the top level management for discharging its functions. Management accounting covers various areas such as cost accounting, budgetary control, inventory control, statistical methods, internal auditing etc. The purpose of this branch of accounting is to supply all information that management may need in taking decisions and to evaluate the impact of its decisions and actions.

ACCOUNTING PRINCIPLES

Meaning of Accounting Principles

The literal (dictionary) meaning of the term Principle is that it is a basic fundamental truth or treaty, which is uniformly accepted and followed by everyone and everywhere. Development of accounting principle took place from time to time based on experience, usage and necessity. *Accounting principles are those rules of action or conduct, which are accepted universally by all accountants in recording transactions in the books of accounts.* (Accounting principles are those rules which are to be adopted by Accountants.) These principles are usually developed by professional accounting bodies.

Accounting principles can be broadly classified into two main categories:

(a) Accounting Concepts

(b) Accounting Conventions

ACCOUNTING CONCEPT OR ASSUMPTIONS

Meaning of Accounting Concept

Accounting is the language of business. In the absence of systematic approach, accountants may use their own language and it may not be understood in the same sense by all concerned parties. With a view to make accounting language a standard language, certain accounting concepts have been developed over a course of period. *Accounting concepts are general guidelines for sound accounting practices.*

Accounting concepts are assumptions and conditions on which the whole accounting structure stands. They are the predetermined condition which a book-keeper must keep in mind, while recording transactions in the books of accounts.

Importance of Accounting Concepts/Principles

1. Ensure uniformity in presentation of financial statements. *(Uniformity in presentation)*
2. Serve the purpose of providing proper information to the stakeholders. *(Proper information to all)*
3. All the stakeholders believe that assumptions on which financial statements are based are valid and appropriate. *(Valid and appropriate assumptions)*
4. Make financial statements reliable. *(Reliable financial statements)*
5. Provide a basis for measurement that is generally acceptable. *(Generally acceptable basis of measurement)*

Some of the Important Concepts are as follows:

1. Entity Concept/Business Entity Concept

Entity means something that has real separate existence. In other words, entity refers to status or personality. The business has separate existence from its owner or proprietor. For instance ,*Mr. X* has been conducting business under the title *Ganesh Medicals* for last so many years. Here, in this case, *Mr. X* and *Ganesh Medicals* are different from each other.

The business unit is separate from its owner is the basic meaning of entity. Under this concept, sole trading concern and sole proprietor are treated as two different entities. According to this concept, only business transactions are recorded in the business book of accounts. Proprietor's personal transactions are not recorded in the books of accounts

Example: Half of the building is used for business office and other half of the building is used for the residence of the proprietor. If the total rent of the building is ` 50,000, then only ` 25,000 will be deducted as drawings from proprietor's capital.

2. Money Measurement Concept

There is a need to express transactions in common unit of measurement, Every transaction is recorded in terms of money. In India, all the accountants use only Indian currency, *i.e.*, 'Rupee' (`). Because of this concept, only monetary items are recorded.

In accounting, everything is recorded in terms of money. Events or transactions, which can not be expressed in terms of money, are not recorded in the books of accounts, even if they are very important or useful for the business. Purchase and sale of goods, payment of expenses and receipt of income are monetary transactions which find place in accounting. Death of executive, resignation of a manager etc. are the events which can not be expressed in money. Thus, they are not recorded in the books of accounts.

Example: A businessman owns following properties;

Land 2000 sq. mtrs. Cost ` 5,00,000, Building 40 Rooms, Cost ` 9,00,000, Raw Material 8 Tonnes, Cost ` 4,00,000

Here, total assets will be recorded by common unit of money measurement and will be valued at ` 18,00,000 in the books of accounts.

3. Cost Concept

This concept does not recognise the realizable value, the replacement value or the real worth of an asset. Thus, as per cost concept.

(a) An asset is ordinarily recorded at the price paid to acquired (got/purchased) it, *i.e.*, at its cost, and

(b) This cost is the basis for all subsequent accounting for the asset.

***Example*:** If a plot of land is purchased for ` 1,00,000 and It is recorded in the books at ` 1,00,000. In case, market value goes to ` 2,00,000 or ` 60,000, it will not be considered.

4. Going Concern Concept

It is the basic assumption that business will continue for a quite long time, it will go on and on and will not be closed down or stopped for a quite long time. Business is not to be closed at its early stage but should give a long life. This principle helps may investors to invest, many suppliers to give credit, many workers or employees to give services.

Example: A stall for marketing of any product or introduction of new product of any business has to be closed immediately after the exhibition is over. But once the business is set up, it continues for a long time.

5. Realization Concept

Income is recorded only when it is realized, *i.e.*, either it is received or earned. Revenues are recorded only when sale are affected or the services are rendered. Sales revenues are considered as recognized when sales are effected during the accounting period irrespective of the fact whether cash is received or not.

Example:

(i) A company gets an order for sale of goods ` 1,00,000/- in May 2014 goods of only ` 60,000/- are sold and delivered in June 2014. Cash is received for ` 60,000/- in September 2014. As per the principle of realization, sale is to be recorded in June 2014.

(ii) A businessman purchased two washing machines from manufacturers for ` 15,000/- each. One out of two is sold for ` 17,000/- and earned a profit of ` 2,000/-. The other one is not sold out then he cannot anticipate and record a profit of ` 2,000/- on the second machine unless and until a sale is realized.

(iii) Money received in advance along with an order is not treated as revenue until the goods are dispatched and sold or services are rendered.

(iv) Similarly, until the asset is sold, appreciation in value of the asset is not to be considered. For example, land is purchased for ` 50,000 in 2010 and after one year if the market price increases to ` 70,000, then ` 20,000 which is appreciation on land should not be considered.

6. Accrual Concept Dual Concept

It implies recording of revenues (Incomes) and expenses of a particular accounting period, whether they are received or paid in cash or not. Income is recorded when it accrues (earned) and expenses are recorded when they accrue (become payable). All expenses and revenues related to the accounting period are to be considered irrespective of the fact, the revenues (Incomes) are received in cash or not or expenses are paid in cash or not. Outstanding expenses and outstanding incomes are entered in the books of Account due to accrual concept.

Example: A company invested ` 2,00,000 with a bank for one year on 1st July, 2009, the bank has to pay interest at 10% p.a. on it maturity, *i.e.*, 30th June, 2010. As per principal of accrual interest of 6 months is ` 10,000 to be shown in income statement as Interest receivable during financial year 1/1/2009 to 31/12/2009.

7. Dual Aspect Concept

Every business transaction has two effects and involves exchange of benefits. Benefit received and benefit given both the aspects should be recorded in the books. The system which records such dual aspects in the books is known as Double Entry System.

This principle also considered as the concept of debit and credit. The account where the benefit comes in is debited and the account where benefit goes out is credited.

Example: A proprietor invested ` 1,00,000 into the business. At one side business gets asset (cash) ` 1,00,000/- and the other side business owes ` 1,00,000/- as capital to the proprietor. Thus, all the debit in the ledger will be equal to all the credits.

8. Revenue Recognition Principle

This principle is mainly concerned with the revenue, being recognised in the Income Statement of an organization. Revenue is the gross inflow of cash receivables or other considerations arising in the course of ordinary activities.

Example: Sale of goods, rendering of services and use of resources by other, yielding interest, royalties and dividends. It excludes the amount collected on behalf of third parties such as certain taxes. In an agency relationship, the revenue is the amount of commission and not the gross inflow of cash receivable or other consideration. Revenue is recognized in the period in which it is earned irrespective of the fact whether it is received or not received during that period.

9. Matching Concept

This concept is very important for determination of profit or loss correctly. According to this concept, the profit of the business is calculated by matching total revenue earned during the year with total expenses incurred during the same period. The difference between the two represents profit or loss. *Excess of revenue over expenses is profit while Excess of expenses over revenue is a loss.*

Following points should be considered:

(i) Any expenses payable for the period should be considered and added to expense.
(ii) Any prepaid expenses should be deducted from expenses paid.
(iii) Income receivable should be added to the revenue (income).
(iv) Income received in advance should be deducted from the revenue.

Example: If a broker has received commission of ` 10,000. Here, ` 10,000 cannot be considered as his profit. He must deduct expenses incurred by him to earn this commission. If he has spent ` 200 on travelling, ` 300 on stationery and ` 500 on advertisement then his real profit will be as shown below:

				`
Commission Received (Income/Revenue)				10,000
Less:	**Expenses**			
	1	Travelling	200	
	2	Stationery	300	
	3	Advertisement	500	
Real Profit				9,000

In the above case, his revenue ` 10,000 are matched with his expenses of ` 1,000.

10. Accounting Period Concept

A business organization is a going concern. It has a continuous life. The correct results cannot be ascertained unless the business is closed down. The proprietor cannot wait indefinitely till the closure of business to know the financial results. Hence, the life span of an organization is divided into the periods of 12 months which is known as accounting year or accounting period. It is also known as fiscal or financial year. It is essential to measure financial health of an organization periodically to enable the stakeholders to take right decision. Hence, financial results are ascertained every year. All the organizations, therefore, prepare financial statements every year.

11. Objective Evidence Concept

According to this concept, all accounting transactions must be supported by proper documentary (paper) evidence. This document includes bills, contracts, pass book, copy of receipt, vouchers etc. This documentary evidence helps the auditor (C.A.) to check the entries in the books of account with their supporting papers. Thus, for each and every entry in the books of account, there should be documentary evidence. Similarly, for each and every documentary evidence of monetary nature, there should be entry in the books of account.

ACCOUNTING CONVENTIONS

Meaning of Accounting Conventions

Dictionary meaning of convention is behaviour and attitudes that most people in a society considered to be normal and right. Accordingly, accounting conventions refer to rules which have common acceptance and agreement in accountancy. In other words, customs or traditions which guide or direct the preparation of accounts are called accounting conventions. In this sense, accounting conventions and accounting concept are synonymous. In short, *accounting conventions means customs or traditions which are followed years together to prepare accounts of the business concern*.

An accounting convention may be defined as a custom or generally accepted practice which is adopted either by general agreement or common consent among accountants.

Difference between Concepts and Conventions

Following is the difference between concepts and conventions:

1. Concepts are established by law whereas conventions are guidelines based upon customs or usage.
2. In adoption of concepts, there is no role of personal judgment where as conventions adoption is affected by personal judgment.
3. Accounting concepts are adopted in different enterprises to bring uniformity. There cannot be uniformity in adoption of accounting conventions by different enterprises.

Different Accounting Conventions are as follows:

1. Convention of Disclosure/full Disclosure

The accounts must disclose all material (important) information. The accounting reports should disclose full and fair information to the related parties. The financial position and performance should be disclosed very honestly to all the users. The financial position means the Balance Sheet of the business and financial performance means business results in terms of profits or losses and income and expenses in profit and loss account.

All the information disclosed should be relevant, reliable, comparable and understood by all the concerned authorities.

This accounting convention is more relevant or made applicable to a joint stock company where there is separation of ownership and management. As per the provisions of Companies Act, 1956, financial statement and report prepared by the company must give a true and fair view of the state of affairs of the company.

Note: Full disclosure does not mean all small points which should be discussed and mentioned like purchase of motor car, its number, colour, which company, with or without carrier, etc.

2. Convention of Materiality

Material means important. The accountant should attach importance to material (important) details and ignore insignificant (unimportant) details. If this is not done, accounts will be overburdened with minute (small) details. As per the American Accounting Association, "an item should be regarded as material, if there is a reason to believe that knowledge of it would influence the decision of informed investor." Therefore, keeping the convention of materiality in view, unimportant items are either left out or merged with other items or shown as foot notes.

Note: However, an item may be material for one purpose but immaterial for another, material for one concern but immaterial for another, or material for one year but immaterial for next year.

3. Convention of Consistency/Consistency Concept

Any policy adopted for accounting should be continuous or consistent throughout the business and it need not be changed generally unless and until circumstances demand. However, it does not stop any improvement of new techniques. But that should be disclosed with a note.

For instance, there are several methods of depreciation, to charge depreciation on fixed assets. Once particular method of depreciation is adopted to charge depreciation on fixed assets, it should be followed consistently for years together.

The convention of consistency has the following advantages:

(i) It ensures comparability of financial statements of different years.

(ii) It eliminates an element of uncertainty regarding the accounting procedure to be followed.

(iii) It also eliminates the element of any personal bias regarding preparation of accounts and accounting reports.

4. Convention of Conservatism

It refers to the policy of 'playing safe'. *As per this convention all prospective (possible and expected) losses are taken into consideration but not all prospective (possible and expected) profits. In other words anticipate no profit but provide for all possible losses.*

Under this convention, if there are two figures representing losses or liabilities, then the higher one must be selected and on the other side, if there are two figures representing profit or assets, then the lower one should be selected. In short, conservatism means to follow the safe side.

However, this convention is being criticised on the ground that it goes not only against the convention of full disclosure but also against the concept of matching costs and revenues. It encourages creation of secret reserves by making excess provision for depreciation, bad and doubtful debts etc. The Income statement shows a lower net income and the Balance sheet overstates the liabilities and understates the assets.

Following are the examples of application of conservatism:

(i) Making provision for doubtful debts and discount on debtors.

(ii) Not providing for discount on creditors.

(iii) Valuing stock in trade at cost or market price whichever is less.

(iv) Creating provision against fluctuations in the price of investments.

(v) Showing Joint Life Policy at surrender value and not at the paid-up value.

Accounting Principles

Accounting Concepts

1. Entity concept
2. Money measurement concept
3. Cost concept
4. Going concern concept
5. Realization concept
6. Accrual concept
7. Dual aspect concept
8. Revenue recognition concept
9. Matching concept
10. Accounting period concept
11. Objective evidence concept

Accounting Convention

1. Convention of Disclosure
2. Convention of Materiality
3. Convention of consistency
4. Convention of Conservatism

INTRODUCTION TO DOUBLE ENTRY SYSTEM

There are different methods of recording accounting information. They are as follows:

1. Indian system
2. English system
   (a) Single entry system
   (b) Double entry system
3. Conventional accounting system

INDIAN SYSTEM

It is the most conventional (traditional) system of accounting. It is also called Mahajani/ Marwadi/Deshi Nama system. Under this system, records are maintained in Indian language, such as Marathi, Hindi, Marwadi, Urdu etc. Transactions are recorded in long books known as kird and Bahi Khata. This system of accounting is not based on Double Entry system. Though this system is not scientific, it is still being used in India in small sized business.

ENGLISH SYSTEM

In English system, business transactions are recorded systematically in a separate set of books such as journal and ledger, in the English language as per modern style. English system is more advanced and extensively used nowadays all over the world. Even in India, English system is more preferred and extensively used in almost all types of business organizations. English Book-keeping system is broadly reclassified as (A) Single entry book-keeping system and (B) Double entry book-keeping system.

Single Entry Book-keeping System

Under this system, only Cash Book (Cash A/c) and Personal Accounts, are maintained. This system is known as incomplete system of recording because it changes with the convenience of businessman. Therefore it is not a scientific and complete method of recording. It cannot provide accurate information about the financial position of business. It is unscientific method having number of defects. It is suitable to small traders.

Due to many limitations (defects/drawbacks), now single entry system is rarely used is modern business.

Double Entry Book-keeping System

Origin of Double Entry System

Double Entry System of Book-keeping has emerged in process of evolution of various accounting techniques.

The credit of evolving the present Double Entry Book-keeping system goes to a philosopher turned mathematician Italian merchant "Luca D. Bargo Pacioli" in 1494.

Meaning of Double Entry System

Every business transaction involves an exchange of money or money's worth (*i.e.,* goods or services or anything). An exchange involves two parts, *i.e.,* receiving and giving. The system of book-keeping which records both the aspects of transactions is known as double entry system of book-keeping. There cannot be business transactions without two effects. When a businessman gives something, he gets something else in return. These two aspects affect two accounts – one account receives the benefit and the other account gives the benefit. A business transaction is comparable with a coin with two sides. As a coin has two sides, a transaction affects two accounts.

Double entry book-keeping does not mean the transaction is to be recorded two times. It is a complete record of business transactions, that is, recording both the aspects of a transaction, *i.e.,* debit and credit. Amount of benefit received by one account is equal to the amount of benefit given by the other account. In other words, amount of debit is always equal to the amount of credit. Today, most of the business concerns have adopted this system.

Recording dual (double) aspects of business transactions in the books of accounts in terms of debit and credit is known as *'Double Entry System of Book-keeping'*.

Definitions of Double Entry System

"Every business transaction has a two fold effect and that it affects two accounts in opposite directions and if a complete record is to be made of each such transaction it would been necessary to debit one account and credit another account. It is this recording of twofold effect of every transaction that has given rise to the term Double Entry."

– J.R. Batliboi

"The Double Entry System seeks to record every transaction in money or money's worth in its double aspect – the receipt of a benefit by one account and the surrender of a like benefit by another account, the former entry being to the debit of the account receiving and the later to the credit of the account surrendering."

– William Pickles

Principles/Features of Double Entry System

Following are the main principles/features of Double Entry System of Book-keeping.

1. Every transaction has minimum two aspects.
2. These two aspects involve two accounts, *i.e.,* every transaction affects two accounts.
3. One account receives the benefit and the other account gives the benefit.
4. One account is debited and the other account is credited with equal amount.

Main Principle of Double Entry System

"Every debit has corresponding credit and every credit has corresponding debit with equal amount."

Examples:

(a) Furniture is purchased for ` 2,000 for which cash is paid.

Here, furniture comes in and cash goes out.

Two accounts are affected, *i.e.*, Furniture and Cash.

(b) Cash paid to Mr. Rakesh ` 3,000.

Here, two accounts are affected. One is Mr. Rakesh A/c (who is receiver) and second is Cash A/c (goes out)

Advantages of Double Entry System of Book-keeping

1. **Complete Record:** Since both the debit and credit aspects of every transaction are fully recorded, a complete record of all transactions is obtained.
2. **Accuracy:** As every debit has a corresponding credit, and every credit has a corresponding debit, the arithmetical accuracy of the books of account on any given date can be easily verified.
3. **Item-wise Details:** The detail information with respect to different types of expenses, incomes, losses, gains, assets, liabilities, debtors, creditors, etc. is easily made available under double entry system of book-keeping. This is because under this system all ledger accounts are prepared separately.
4. **Comparative Study/Facilitates Planning:** Under double entry book-keeping system, comparison between the results of current year with the previous year can be done easily which in turn helps to prepare planning for the future activities.
5. **Common Acceptance:** The records prepared and maintained under double entry book-keeping system have common approval and acceptance from financial institutions, government authorities and others.
6. **Provides Useful Financial Information:** Financial position of the business and yearly performance of the business activities, *i.e.*, profit or loss can be known easily if double entry book-keeping system is followed. On the basis of such financial information management can easily provide useful information to various users.
7. **Helpful for Management:** Under this system, accountants can easily provide periodical financial information to the management on various aspects of the business. On the basis of these data and information, management can take corrective steps to develop and control business activities.

8 **Control Errors and Frauds:** Because of the counter-checks provided by the equality of debits and credits, it is difficult to commit errors and frauds, and easy to detect them if at all they are committed. Thus, double entry book-keeping system is useful to control errors and frauds.

INTRODUCTION TO ACCOUNTS

As per the concept of double entry system, every business transactions has a two effects, *i.e.*, Debit and Credit.

An account as we understand it, as a systematic record of transaction related to a person, property, expenses, or income. Every account has a two sides. The left hand side known as the Debit side and the right hand side is known as Credit side. To debit an account means to record the transaction on debit side and credit an account means to record the transaction on credit side.

Dr. **____________A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`

For complete record of business transaction, the firm has to record all the business transactions that it has deal with. For this purpose, accounts are classified as follows.

TYPES OF ACCOUNTS

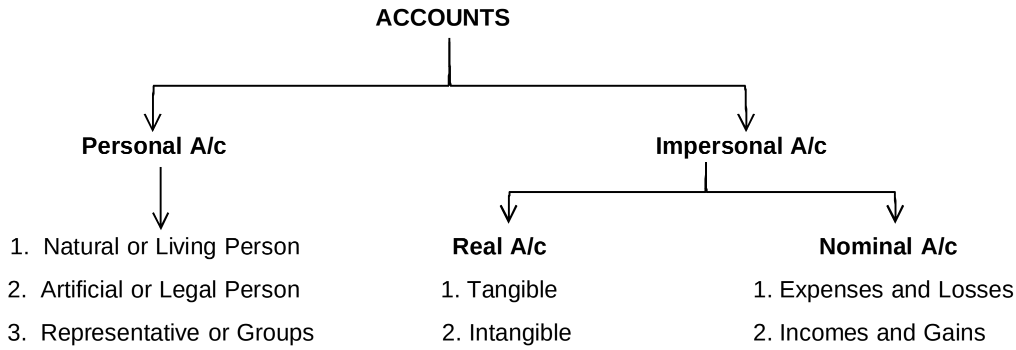
Accounts are classified as follows:

(I) Personal Account

(II) Impersonal Account

(a) Real Account

(b) Nominal Account



(I) Personal A/c

Personal Accounts includes the accounts of persons or parties with whom the business deals. Personal Accounts can be classified into three categories.

(a) Natural or Living Personal A/cs

These accounts are related to natural or living persons. Natural persons means persons who are creation of God. In other words, human beings are natural persons. These are the accounts of persons created by nature, *e.g.*, Meena's A/c, Mr. Raj's A/c, Miss Reshma's A/c, Ram's A/c, Rahim's A/c etc.

(b) Artificial or Legal Personal A/cs

These persons do not have life, body or soul but transactions are done by it in its own name and exist in the eyes of law or recognized by law. These are the accounts of person created by provisions of law. These accounts are related to non-living persons, artificial persons or legal persons. These accounts include accounts of corporate (registered) bodies or institutions, *e.g.*, Partnership Firms, Cooperative Societies, Companies, Clubs, Associations, Municipality, Central or State Government, Insurance Companies, Charitable Trust, Legal Authorities etc.

(c) Representative or Groups Personal A/cs

These accounts represents certain person or groups, *e.g.*, Capital, Drawing, Debtors, Creditors, Outstanding rent, Interest payable, Prepaid Insurance, Salary paid in advance, Interest receivable, Pre-received commission, rent received in advance, Unexpired Insurance.

PERSONAL A/C

Natural or Living

1. Mr. Ramesh's A/c
2. Miss Rati's A/c
3. Mrs. Kapoor's A/c
4. Mr. Ravi's A/c
5. Raj's A/c

Artificial or Legal

1. N.L. College A/c
2. Bank of India A/c
3. Bank A/c
4. Paras Classes A/c
5. Suchak Hospital A/c
6. Clubs A/c
7. Tata Ltd. A/c
8. Asian Paints Ltd. A/c
9. Nutan School A/c
10. Western Railway A/c
11. Government of India's A/c
12. Unexpired Insurance A/c
13. Unpaid Wages A/c

Representative or Group

1. Capital A/c
2. Drawings A/c
3. Debtors A/c
4. Creditors A/c
5. Outstanding Rent A/c
6. Interest Payable A/c
7. Prepaid Insurance A/c
8. Salary Paid in Advance A/c
9. Interest Receivable A/c
10. Pre-received Commission A/c
11. Rent Received in Advance A/c

Note: Outstanding (O/s) (accrued)/ Receivable/ Payable/Pre-received/prepaid/received in advance paid in advance/unexpired (prepaid)/ unpaid.

Rule of Personal Account
Debit the Receiver
Credit the Giver

Examples:

1. *Mr. A paid ₹ 500 to Mr. B on our behalf.*

   Soln: B's A/c – Personal A/c – Receiver – Debit

   A's A/c – Personal A/c – Giver – Credit

2. *Mr. X received ₹ 1,000 from Mr. Y on our behalf.*

   Soln: X's A/c – Personal A/c – Receiver – Debit

   Y's A/c – Personal A/c – Giver – Credit

3. *Laxmi Medical paid ₹ 5,000 to Ganesh Medical on our behalf.*

   Soln: Laxmi Medical's A/c – Personal A/c – Giver – Credit

Ganesh Medical's A/c – Personal A/c – Receiver – Debit

4. *Raj received ` 7,000 from XYZ General Stores on our behalf.*

   Soln: Raj's A/c – Personal A/c – Receiver – Debit

   XYZ General Stores's A/c – Personal A/c – Giver – Credit

(II) Impersonal A/c

All accounts other than personal accounts are called impersonal account. There are two types of impersonal accounts.

(a) Real A/c

(b) Nominal A/c

(a) Real Account

It is also known as Property A/c. These accounts relate to all kinds of properties and assets possessed by business. The assets may be tangible or intangible.

(i) Tangible Real A/cs: These accounts consists of assets and properties which can be seen, touched, felt and measured.

e.*g.*, Cash A/c, Building A/c, Stock A/c, Machinery A/c, Furniture A/c etc.

(ii) Intangible real accounts: These accounts consists of assets and properties which cannot be seen, touched but they are capable of measurement in terms of money.

e.g., Goodwill, Copyright, Trade Marks, Patent Right etc.

REAL OR PROPERTIES A/C

Tangible real A/c

1. Cash A/c
2. Goods A/c
3. Machinery A/c
4. Stock A/c
5. Building A/c
6. Furniture A/c
7. Motor Car A/c

Intangible real A/c

1. Goodwill A/c
2. Patent Right A/c
3. Trade Marks A/c
4. Copy right A/c

Rule of Real A/c
Debit what comes in
Credit what goes out

Examples:

1. *Goods purchased for cash ` 5,000*

   Soln: Goods A/c – Real A/c – Comes in – Debit

   Cash A/c – Real A/c – Goes out – Credit

2. *Goods sold for Cash ` 8,000.*

   Soln: Cash A/c – Real A/c – Comes in – Debit

   Goods A/c – Real A/c – Goes out – Credit

3. *Goods purchase of ` 3,000 from Raj on credit.*

   Soln: Goods A/c – Real A/c – Comes in – Debit

Raj's A/c – Personal A/c – Giver – Credit

4. *Goods sold of ` 6,000 to Pankaj Stores on credit.*

Soln: Goods A/c – Real A/c – Goes out – Credit
Pankaj Stores' A/c – Personal A/c – Receiver – Debit

5. *Goods purchased of ` 2,000 and amount paid by cheque.*

Soln: Goods A/c – Real A/c – Comes in – Debit
Bank A/c – Personal A/c – Giver – Credit

6. *Paid ` 12,000 to Rajnikant by Cash.*

Soln: Rajnikant's A/c – Personal A/c – Receiver – Debit
Cash A/c – Real A/c – Goes out – Credit

(b) Nominal Account

These are the accounts of expenses or losses and incomes or gains. These accounts are called fictitious accounts as they do not represent any tangible asset. They exist only in name and cannot be seen or touched. A separate account is maintained for each head of expense or loss or income or gain, *e.g.*, interest account, commission account, discount account, postage and telegrams account, rent account, salaries account etc.

Nominal A/cs or Fictitious A/cs

1. Bank Charges A/c
2. Rent A/c
3. Salaries A/c
4. Clearing Charges A/c
5. Wages A/c
6. Audit Fees A/c
7. Insurance Premium A/c
8. Printing and Stationery A/c
9. Repairs A/c
10. Loss by Fire A/c
11. Advertisement A/c
12. Import Duty A/c
13. Brokerage A/c
14. Commission A/c
15. Carriage A/c or Cartage A/c
16. Postage and Telegram A/c
17. Membership Fees/Subscription A/c
18. Sundry Expenses A/c
19. Royalties A/c
20. Freight A/c
21. Travelling Expenses A/c
22. Discount A/c
23. Dividend A/c
24. Interest A/c
25. Electricity Charges A/c
26. Purchase A/c
27. Sales A/c
28. Purchase Return A/c
29. Sales Return A/c

Rule of Nominal Account
Debit all expenses and losses
Credit all incomes and gains.

Examples:

1. *Salary paid ` 2,000/-.*

Soln: Salary A/c – Nominal A/c – Expenses – Debit
Cash A/c – Real A/c – Goes out – Credit

2. *Rent paid ` 5,000/- by cheque.*

   Soln: Rent A/c – Nominal A/c – Expenses – Debit
   Bank A/c – Personal A/c – Giver – Credit

3. *Interest received ` 1,500/-.*

   Soln: Cash A/c – Real A/c – Comes in – Debit
   Interest A/c – Nominal A/c – Income – Credit

4. *Commission received ` 2,500/- by cheque.*

   Soln: Bank A/c – Personal A/c – Receiver – Debit
   Commission A/c – Nominal A/c – Income – Credit

5. *Goods purchased for cash.*

   Soln: Purchase A/c – Nominal A/c – Expenses – Debit
   Cash A/c – Real A/c – Goes out – Credit

6. *Goods sold on credit to Mr. Nayak.*

   Soln: Nayak's A/c – Personal A/c – Receiver – Debit
   Sales A/c – Nominal A/c – Income – Credit

RULES

(1) PERSONAL A/c	**(2) REAL A/cs**	**(3) NOMINAL A/cs**
Debit the Receiver	Debit what comes in	Debit all expenses and losses
Credit the Giver	Credit what goes out	Credit all incomes and gains

CONCLUSION

In this chapter, we have studied the basic concept and convention in Book-keeping and Accounting and also studied the application of this concept and convention in financial account. A strong conceptual base is a backbone of financial accounting, reporting and analysis.

In this chapter, we studied the concept of double entry system. This system says that, every business transaction has a two effect, like a two sides of a coin. And its superiority over conventional method of accounts. This system is legally approved by all the authorities.

Practical Problems

Q.1. Classify the following Accounts into Personal, Real and Nominal

1. Stock A/c
2. Bank of India's A/c
3. Capital A/c
4. Furniture and Fitting A/cs
5. Pratap Nagar Coop. Hsg. Soc. Ltd. A/c
6. Cash A/c
7. Building Repair A/c
8. Outstanding Salary A/c
9. Debtors A/c
10. Investments A/c
11. M/s Raj & Co.'s A/c
12. Plant and Machinery A/c
13. Drawing A/c
14. Mahesh Stores A/c

Q.2. Classify the following Accounts into Personal, Real and Nominal

1. Loan to Shashikant A/c
2. Deposit A/c
3. Motor Van A/c
4. Typewriter A/c
5. Freight A/c
6. Loan from Khan's A/c
7. Govt. of India's A/c
8. Loose Tools A/c
9. Royalties A/c
10. Chate Coaching Classes A/c
11. Navneet Pub. Ltd. A/c
12. Shares in Reliance Ltd. A/c
13. Stationery A/c
14. Dividend Received A/c
15. Electric Fittings A/c
16. Rent Received A/c
17. Rent Receivable A/c
18. Rent Received in Advance A/c
19. Rent Paid A/c
20. Rent Payable A/c
21. Rent Paid in Advance A/c
22. Prepaid Rent A/c
23. Outstanding Rent A/c
24. Subscriptions A/c
25. Audit Fees A/c
26. Drawing A/c
27. Capital A/c
28. Import Duty A/c

Q.3. Classify the following Accounts into Personal, Real and Nominal

1. Raj Library A/c
2. Electricity A/c
3. Live Stock A/c
4. Goods A/c
5. Purchase A/c
6. Sales A/c
7. Unpaid Wages A/c
8. Purchase Return A/c or Return Outward A/c
9. Sales Return A/c or Return Inward A/c
10. Prepaid Insurance A/c
11. Investment A/c
12. Gas and Light A/c
13. Shares A/c
14. Debentures A/c
15. Machine Upkeep A/c (Repair/Maintenance)
16. Bad Debts A/c
17. Bank commission A/c
18. Tools and Equipment A/c
19. Leasehold/Freehold Premises (Building) A/c
20. Profit on Sale of Furniture A/c
21. Telephone Deposit A/c
22. Bills Receivable A/c
23. Bills Payable A/c
24. Freight A/c
25. XYZ Pvt. Ltd. A/c
26. Loss on Sale of Investment A/c

Q.4. State with the help of a table, which account will be debited and which account will be credited. Give reasons. (Analysis of Transaction)

1. Rajesh commenced (started) business with cash. OR
   Rajesh invested cash in the business.
2. Goods purchased for cash from Mahesh.
3. Goods purchased on credit from Rahul.

4. Sold goods for cash to Pankaj.
5. Sold goods to Ali on credit.
6. Purchased machinery for cash.
7. Purchased furniture from Sanjay on credit.
8. Paid for purchase of stationery.
9. Paid salary to clerk Mr. Sharma.
10. Purchased Goods from Piyush on credit.
11. Paid office rent.
12. Commission received from Chintan by cheque.
13. Interest received from Sumit.
14. Cash deposited into Bank.
15. Cash withdrawn from Bank.

Q.5. Prepare a chart showing the names of two accounts affected, their types, Rule applied and nature of effect – Debit/Credit from the following transactions. (Analysis of transaction)

1. Commenced business with cash.
2. Goods purchased for cash from Mr. Chand.
3. Goods purchased from Mr. Suraj and amount paid by cheque.
4. Goods purchased from Mr. Mangal on credit.
5. Cash purchases of ` 3,000.
6. Purchased goods from Mr. Ravi.
7. Goods purchased of ` 6,000.
8. Further cash introduced (brought) in business by owner.
9. Machinery brought in the business by owner.
10. Received dividend from Reliance Industries Ltd.
11. Opened Bank A/c with ` 5,000.
12. Return goods to Mr. Ravi.
13. Travelling expenses paid to clerk Mr. A.
14. Carriage paid on goods sold to Mr. King. OR
    Carriage paid on sale of goods to Mr. King.
15. Insurance premium paid by cheque.

Q.6. Record the following transactions in a tabular form after applying the steps of Golden rule. (Analysis of Transaction)

1. Proprietor brought his personal car into business.
2. Cash withdrawn from business for personal use.
3. Borrowed (loan taken) from Miss Rajani.
4. Goods sold for cash to Mr. Sarad.
5. Goods sold to Mr. Shishir and amount received by cheque.
6. Goods sold to Mr. Vasant on credit.
7. Cash sales of ` 5,000/-.

8. Sold goods to Miss Varsha.
9. Goods sold of ` 10,000/-.
10. Goods return from Mr. Vasant.
11. Paid College fees of Proprietor‘s son studying at H.R. College.
12. Paid salary to Ramu.
13. Postal stamps bought of ` 50.
14. Loan taken from Mr. Changu of ` 10,000.
15. Loan given to Mr. Mangu of ` 25,000.

Proforma for Analysis of Transaction

Transaction No.	Names of A/cs or Two A/cs Involved	Types of A/c	How Each Aspect is Affected	Rules Applied	Effect Debit/Credit

EXERCISE

Short Answers

1. Distinguish between Book-keeping and Accountancy.
2. Objectives of Book-keeping and Accountancy.
3. What do you mean by accounting principles?
4. What is business entity concept?
5. What is going concern concept?
6. Principle of conservatism.
7. Explain dual aspect concept.
8. What are the types of accounts?
9. What is personal account and its rule?
10. What is real account and its rule?
11. What is nominal account and its rule?

Long Answers

1. Define Book-keeping and explain its features.
2. Explain the importance of Book-keeping and Accountancy.
3. Describe the utility of Book-keeping and Accountancy.
4. Explain the double entry system of Book-keeping.
5. Explain the advantages and disadvantages of double entry system.
6.. Difference between double entry system and single entry system.

Essay Type Questions

1. Define accounting.
2. Explain the objects of accounting.
3. Explain the necessity of accounting in a business organization.

4. Explain the process involved in accounting.
5. What are the objectives of accounting?
6. How accounting information is used by investors and lenders?
7. How Government and Regulatory agencies use accounting information to regulate the activities of the firm?
8. Distinguish between financial accounting and management accounting.
9. What are the basic principles of Accountancy?
10. The salaries paid in 2004 ` 5,00,000; Salaries outstanding ` 20,000; Salaries paid in advance for 2004 ` 30,000; What is the actual salary expenditure for 2004? What is the accounting principle involved in this?
11. What is wrong if assets like buildings are shown at market value in the balance sheet?
12. A business receives capital of ` 1,00,000 and a loan is raised for ` 50,000. This is represented by cash ` 15,000; Machinery ` 85,000; Furniture ` 20,000 and goods ` 30,000. Find the total of debits and credits from business point of view. What principle of accounting is underlying in this case?
13. What is substance over form?

Objective Type Questions

Fill in the blanks with proper words

1. Book-keeping _________ the transactions and events, _________the identified transactions and events in a common measuring unit, records them in proper books of accounts and finally classifies them in the ledger.
2. Accounting in addition to book-keeping involves ________ the classified transactions and ________ the summarized results.
3. ____________ interprets the analyzed results and communicates the interpreted information to the interested parties.
4. Accounting is a tool for _______________ and ________.
5. Expand SEBI.
6. Mention any five stakeholders.
7. ________ as chief provider of risk capital is keen to understand both the return from their investments and the associated risk.
8. _________ use financial reports for negotiating wage package, declaration of bonus and other benefits.
9. ___________ has a legitimate interest in financial reports of publicly held enterprise to ensure efficient operation of capital market.
10. The regulatory agencies use _____________ to take action against the firm when appropriate returns are not filed in time or when the returns fails to provide true and fair position of the business or to take appropriate action against the firm when complaints/misappropriation are being lodged.
11. Accounting grossly lacks ____________elements.
12. The exact picture of the financial situation can be ascertained only on the ________of an enterprise.

13. The danger of ___________ arises when the management decides to incorporate wrong figures to artificially inflate revenue or deflate losses or when there is a threat of hostile takeover.
14. Accounting ignores the price level changes when financial statements are prepared on ___________.
15. Accounting principles are _______, associated with theory and practice of accountings.
16. Accounting principles are classified as ________ and ________.
17. The purpose of establishing ICAI and ASB is to ________.
18. Business and its owner are _______________ entities.
19. Profits earned in business form an addition to the _____________ of the owner.
20. Transactions or events should be expressed in ___________
21. Interest earned but not received within an accounting period is called _______.
22. Accrued income should be _________ to compute profit and prepaid expenses should be _____ according to accrual concept of accounting.
23. Accrual concept considers not only cash transactions but also ______ transactions.
24. Income is considered as earned only when it is ____________.
25. All revenue expenses are charged against ___________.
26. Incomes and expenses for an accounting period are considered to compute _____.
27. For the actual revenue received, outstanding incomes are ________ and income received in advance are_________________ to find out the revenue income for the given period.
28. For the actual revenue expenses (costs) paid during the accounting period, outstanding expenses are _____ and prepaid expenses are _____ to find out expenses for the accounting period.
29. The principle of full disclosure implies that information which is of ___________ should be stated in financial statements.
30. Non-disclosure of material information amounts to ___________.
31. Total liabilities should be equal to ___________ as per dual aspect principle.
32. For every debit, there should be an equivalent credit. This is called _________ of accounting
33. Modifying principle is also known as _____________.
34. The purpose of principle of consistency is to help for ______ from one period to another period.
35. Provision should be made whenever _____________ is anticipated.
36. The underlying spirit of principle of conservatism is __________ .
37. Double entry system of book-keeping denotes that every business transactions has ____ effects.
38. The method of writing every financial transaction in two accounts in called as ____ system of Book-keeping.
39. In every transaction, at least ____ parties are involved.
40. In ____ system, businessman writes accounts in vernacular of Indian language.
41. An account is always divided into ____ sides.
42. The left hand side of the account is called ____ side.
43. Cash Account shows the receipts and ____ in cash.

44. The accounts of properties and assets are called the ____ accounts.
45. ____ accounts are those of people.
46. Sales Tax Account is a ____ Account.
47. Manufacturing wages Account is a ____ Account.
48. Dividend Received Account is a ____ Account.
49. Audit Fees Account is a ____ Account.
50. Bombay University Account is a ____ Account.
51. Livestock Account is neither a ____ Account nor a ____ Account.
52. Investment Account is a ____ Account.
53. Insurance Premium Account is a ____.

[**Ans:** 1. Identifies, measures, 2. Summarizing, analyzing, 3. Accounting, 4. Effective planning, controlling, 5. Securities Exchange Board of India, 6. Shareholders, Creditors, Bankers, Government, Employees, 7. Investors, 8. Trade Union, 9. Stock Exchange, 10. Financial Reports, 11. Qualitative, 12. Liquidation, 13. Window dressing, 14. Historical Cost, 15. Doctrines, 16. Concepts, conventions, 17. Bring uniformity in accounting terminology and principles, 18. Separate, 19. Capital, 20. Monetary value, 21. Accrued interest, 22.Added, Deducted, 23. Credit, 24. Realized, 25. Profit, 26. Profit or loss, 27. Added, Deducted, 28. Added, Deducted, 29. Substance, 30. Fraud, 31. Total Assets, 32. Double entry principle, 33. Cost-benefit principle, 34. Comparison, 35. Risk, 36. Anticipate no profit but provide for all anticipated losses, 37. two fold, 38. double entry system, 39. two, 40. Indian system, 41. two, 42. debit, 43. payments, 44. Real, 45. Personal, 46. Nominal Account, 47. Nominal Account, 48. Nominal A/c, 49. Nominal, 50. Personal Account, 51. Nominal Account, Personal, 52. Real Account, 53. Nominal Account.]

State whether the following statements are True or False

1. If the household expenses of ` 25,000 of a proprietor are shown as business expenses, the profit of the business will be understated to the extent of ` 25,000.
2. If a proprietor invests ` 1,00,000 in the business, it is deemed that the proprietor has given ` 1,00,000 to the "business" and it is shown as an asset in the books of the business.
3. Accounting of a small calculator as an expense and not as an asset is the application of principles of prudency.
4. Classification of assets as current and fixed assets is the application of going concern concept.
5. Purchase of a building for your business is made under the assumption that it would last for a long period. This is in accordance with the materiality principle.
6. An event or a transaction expressed in monetary value is measured but inflation or changes in the purchasing power are ignored in money measurement concept.
7. Revenues are matched with expense in accordance with money measurement principle.
8. The economic life of the entity is artificially split into periodic intervals in accordance with periodicity concept.
9. The accounting data must disclose all relevant information in accordance with periodicity concept.
10. The accountants are free to submit financial statement at arbitrary points in time during the life of the entity. This is in accordance with periodicity concept.

11. Following straight line method of depreciation of a particular asset year after year adhere to consistency concept.
12. Income is realized whether it is actually received in cash or promised to be received.
13. Income realized is different from cash received.
14. A sale is made on credit. Does it constitute income realization?
15. An order is received for sale of goods. Is it realization of income?
16. An order is received with an advance of ` 1,00,000 cash. Can this be called income?
17. A cash payment may be a revenue payment or capital payment.
18. A payment which is revenue in nature is expenditure.
19. Capital payments resulting in acquisition of assets appear in the balance sheet.
20. Matching concept of accounting considers only revenue incomes and expenses relating to a particular accounting period.
21. Expenditure paid or payable and revenue earned whether realized or not in cash are taken into account to find out profit or loss.
22. All assets are shown at historical cost in balance sheet.
23. Depreciation is charged against the historical cost of assets.
24. Historical cost is the cost at which an asset is actually purchased.
25. Inflation accounting has emerged as a result of limitation of historical cost concept.
26. The material information that is disclosed should be of great interest to the average investors.
27. Disclosing about assets without disclosing about liabilities is against the principle of full disclosure.
28. Under dual aspect principle, total benefits received by business should match with total benefits given.
29. The modifying principles states that benefit derived should overweigh the cost of implementing it. .
30. A firm plans to establish costing department. By doing so, it was estimated that the cost of the product would increase by 50%. Is it advisable to have cost department?
31. Principle of materiality states that relevant information should be given to relevant parties.
32. Details of debtors should be given to creditors.
33. The material information to one party need not be so for another party.
34. The method of depreciation adopted should be disclosed to Income Tax Authorities.
35. Consistency principle helps for proper assessment of profit or loss.

[**Ans;** 1. True, 2. False, 3. False, 4. True, 5. False, 6. Yes, 7. False, 8. True, 9. False, 10. False, 11. True, 12. True, 13. True, 14. True, 15. False, 16. False, 17. True, 18. True, 19. True, 20. True, 21.True, 22. True, 23. True, 24. True, 25. True, 26. True, 27. True, 28. True, 29. True, 30. False, 31. True, 32. False, 33. True, 34. True, 35. True.]

Match the column

Group A	Group B
1. Books of accounts	(a) Property belonging to a person or a firm
2. Book-keeping	(b) Inability to clear financial obligations
3. Goods	(c) Evidence in court of law
4. Assets	(d) Commodities in which trader deals

5. Insolvency	(e) Record of financial transactions
	(f) Capital – Liabilities = Assets
	(g) Journal
	(h) Ability to clear financial obligations

Ans.: 1. (c), 2. (e), 3. (d), 4. (a), 5. (b).

Group A	Group B
1. Transaction	(a) Trader regularly deals in
2. Journal	(b) Main books of accounts
3. Assets	(c) Dealings between two persons
4. Goods	(d) Social science
5. Book-keeping	(e) Property belonging to person

Ans.: 1. (c), 2. (b), 3. (e), 4. (a), 5. (d).

Group A	Group B
1. Book-keeping	(a) Property of any description
2. Transaction	(b) Dealings between two or more persons
3. Assets	(c) A science or an art
4. Goods	(d) Commodity in which trader deals

Ans.: 1. (c), 2. (b), 3. (a), 4. (d).

Group A	Group B
1. Book-keeping	(a) Basis for wage demand
2. Accounting Reports	(b) Evidence in a court of law
3. Books of Accounts	(c) Exchange of goods or services
4. Business dealings	(d) Inability to pay obligations
5. Insolvency	(e) Record of financial transactions

Ans.: 1. (e), 2. (a), 3. (b) , 4. (c) , 5. (d).

Group A	Group B
1. Concept	(a) Rules or norms
2. Principles	(b) Continuity of activity
3. Going concern	(c) Common idea
4. Cost concept	(d) Not providing for discount on creditors
5. Conservatism	(e) The balance sheet shows true position
6. Convention of disclosure	(f) Suggests to consider purchase price of an asset for recording
	(g) Goodwill
	(h) Contingent liabilities

Ans.: 1. (c), 2. (a), 3. (b), 4. (f), 5 (d), 6. (e)

Group A	Group B
1. Dual Aspect 2. Going Concern 3. Money Measurement 4. Realization	(a) Continuity of activity (b) Every business transaction has a dual effect (c) Profit should be accounted for only when it is actually realized (d) In accounting everything is recorded in terms of money

Ans.: 1. (b), 2. (a), 3. (d), 4. (c).

Group A	Group B
1. Double Entry Book-keeping 2. Indian System of Accounting 3. Cash system 4. Every account	(a) Deshinama system (b) Every transaction has two effects (c) Two sides (d) Cash transactions

Ans.: 1. (b), 2. (a), 3. (d), 4. (c).

Group A	Group B
1. Recording both the aspects of transactions 2. Abhay's Account 3. Building Account 4. Goodwill Account 5. Nominal Account is debited 6. Nominal Account is credited	(a) Personal Account (b) Double entry system (c) Intangible Real Account (d) For incomes and gains (e) Tangible Real Account (f) For expenses or losses

Ans.: 1. (b), 2. (a), 3. (e), 4. (c), 5. (f), 6. (d).

Group A	Group B
1. Real Account is debited 2. Interest Account 3. Prepaid Interest Account 4. Real Account is credited	(a) Personal Account (b) When something goes out (c) Nominal Account (d) When something comes in

Ans.: 1. (d), 2. (c), 3. (a), 4. (b).

Group A	Group B
1. Machinery Account 2. Left hand side of the Account 3. Right hand side of the Account 4. Bad Debts Account	(a) Real Account (b) Debit side (c) Nominal Account (d) Credit side

Ans.: 1. (a), 2. (b), 3. (d), 4. (c).

Group A	Group B
1. Nominal Account is debited	(a) When person is giver
2. Nominal Account is credited	(b) Nominal Account
3. Personal Account is debited	(c) For incomes
4. Personal Account is credited	(d) Personal Account
5. Audit Fees Account	(e) For expenses
6. Mumbai credit club Account	(f) When person is receiver

Ans.: 1. (e), 2. (c), 3. (f), 4. (a), 5. (b), 6. (d).

Multiple Choice Questions

1. The art or science which teaches the technique of recording and explaining financial transaction is called _________.
   (a) Recording transactions (b) Book-keeping
   (c) Accounting (d) Book-keeping and accounting
2. The origin of modern accounting was in _________.
   (a) England (b) India
   (c) Italy (d) America
3. Who is the father of modern accounting?
   (a) L.C. Cooper (b) A.W. Johnson
   (c) Luca Pacioli (d) R.N. Carter
4. Which year indicates the period of origin of double entry system of book-keeping?
   (a) 1414 (b) 1394
   (c) 1494 (d) 1449
5. What was the name of the book written by Luca Pacioli?
   (a) Accounting in ancient Italia
   (b) The modern concept on accounting
   (c) Summa de Arithmetica Geometria Proportionate Proportinalita
   (d) Accounting in the past
6. The history of accounting is _________.
   (a) A new discipline (b) Invention of science
   (c) As old as the human civilization (d) A new achievement of social science
7. The principal object of book-keeping is _________.
   (a) Keeping written records of transaction
   (b) Keeping written records of expenditure
   (c) Ascertainment of financial results
   (d) Ascertainment of debit and credit
8. The fields and scope of accounting are _________.
   (a) Confined within business field only
   (b) Extended over individual life only

(c) Extended over all fields of society
(d) Like individual life and business fields

[**Ans:** 1. (b), 2. (c), 3. (c), 4. (c), 5. (c), 6. (c), 7. (a), 8. (d).]

Give one word, term or phrase for the following statement

1. Property of any description.
2. A science which facilitates to maintain proper record of business transactions.
3. Amount invested in a business by the owner.
4. A person whose total assets exceed his liabilities.
5. Excess of assets over outside liabilities.
6. A commodity in which a trader regularly deals.
7. Cash or goods withdrawn from business for personal use.
8. Dealings between two persons.
9. Obligations towards others.
10. A person whose assets are sufficient enough to meet business obligations.
11. A person from whom amount is receivable.
12. A person to whom amount is payable.
13. The concept which states that assets when purchased should be recorded at cost price.
14. The concept which states that business operations will continue forever.
15. A concept on which double entry book keeping system is based.
16. Concept that provides a link between present and future.
17. Amount that is paid or payable for acquisition of asset.
18. System in which entry is recorded for cash as well as credit transactions.
19. Concept which applies to all business organizations.
20. In accounting, everything is recorded in terms of money.
21. Concept which does not recognize the realizable value, the replacement value or the real worth of an asset.
22. A method whereby revenue and expenses are identified with specific periods of time like a month, half year or a year.
23. The accounts must be honestly prepared and they must disclose all material information.
24. Concept under which importance has to be attached to material details and insignificant details are to be ignored.
25. Concept under which comparison of one accounting period with the other is possible.
26. Left side of an account.
27. Traditional method of book-keeping.
28. Type of account in which transactions related to assets are recorded.
29. Effect given in personal account for receiver of benefit.
30. The accounts of persons.
31. Right side of an account.
32. The accounts of assets and properties.

33. The accounts of expenses and losses.
34. A cash book written in local language by Munimji to record all types of transactions.
35. Most scientific system of recording business transactions.
36. Assets may be depreciated on fixed installment method or reducing balance method. Is it a concept or a convention?
37. A business is started with an assumption of making profit. Is this assumption, a concept or a convention?
38. How many accounting standards are issued by ASB so far?
39. What is the underlying intention in making a provision every year when an asset is purchased?
40. Plant is purchased and payment is made. Is it an expenditure or acquisition of asset?
41. Machinery is bought for ` 2,00,000 and its market value is ` 80,000. Which of these values do you consider to mention in the balance sheet according to cost principle?
42. State the name of the relevant accounting principles for the following statements.
    (a) Following FIFO method of stock valuation year after year
    (b) Appending notes to the financial statements.
    (c) Anticipate no profit but provide for all probable losses

[**Ans.:** 1. Assets, 2. Book-keeping, 3. Capital, 4. Solvent, 5. Capital (Net worth), 6. Goods, 7. Drawings, 8. Transaction, 9. Liabilities, 10. Insolvent, 11. Debtor, 12. Creditor, 13. Cost concept, 14. Going concern concept, 15. Dual aspect concept, 16. Going concern concept/concept of continuity/concept of permanency, 17. Cost concept, 18. Accrual system, 19. Entity concept, 20. Money measurement concept, 21. Cost concept, 22. Accrual concept, 23. Disclosure concept, 24. Material concept, 25. Consistency concept, 26. debit side, 27. conventional system of book keeping, 28. real account, 29. debit, 30. personal account, 31. credit, 32. real account, 33. nominal account, 34. conventional cash book, 35. double entry system, 36. Convention, 37. Concept, 38. 32, 39. To replace it after a certain period, 40. Asset Acquisition, 41. ` 2,00,000, 42. (a) Principles of consistency, (b) Principles of full disclosure, (c) Principles of conservatism.]

CHAPTER 2

Introduction to Accounting Standards

ACCOUNTING STANDARDS

Accounting is the art of recording transactions in the best manner possible, so as to enable the reader to arrive at judgments/come to conclusions, and in this regard it is utmost necessary that there are set guidelines. These guidelines are generally called accounting policies. The intricacies of accounting policies permitted companies to alter their accounting principles for their benefit. This made it impossible to make comparisons. In order to avoid the above and to have a harmonized accounting principle, standards are needed to be set by recognized accounting bodies. This paved the way for Accounting Standards to come into existence.

Accounting Standards in India are issued by the Institute of Chartered Accountants of India (ICAI). At present, there are 30 Accounting Standards issued by ICAI.

OBJECTIVE OF ACCOUNTING STANDARDS

The objective of Accounting Standards is to standardize the diverse accounting policies and practices with a view to eliminate to the extent possible the non-comparability of financial statements and the reliability to the financial statements.

The Institute of Chartered Accountants of India, recognizing the need to harmonize the diverse accounting policies and practices, constituted at Accounting Standard Board (ASB) on 21st April, 1977.

ACCOUNTING STANDARDS BENEFITS

Running a business is not just about earning profits, depositing money in the bank, paying employees, and luring more clients and customers. It is about knowing if the business is thriving or if the owner is just investing in something that is not going to earn at all.

Businesses have to have accounting standards to ensure that everything goes smoothly and that cash flow is running perfectly. These accounting measures for businesses also have to adhere to the accounting standards set by regulating bodies like the ASB and the ICAI. This is because there are policies and other documents that are imperative to every accounting act. In many cases, businesses hire the services of auditors and book-keepers in order to make sure that all record-keeping practices re done correctly. Doing so will provide access to investor capital, facilitate reasonable assessment of performance, and prevent costs brought about by legal action.

Here are other reasons why accounting standards are important to every business:

Protecting Investors: By employing accounting standards, investors' interests are ensured as the documents they review are definitely accurate and genuine. As investors, they are interested to know that their money will eventually earn and go back to them. Accounting standards increase the investors' confidence in the business.

Regulatory Compliance: Government regulators set accounting standards that have to be adhered to by all companies. This is both beneficial to the investor or business owner as well as to the customers or clients because it protects all of them from fraud in businesses. It also promotes transparency among the business transactions, which will eventually lead to the improved efficiency of the markets. Following accounting standards set by the ASB and the ICAI will help prevent a company or business from spending on legal actions initiated by the government against it.

Assessing Business Performance: The use of accounting standards will enable a business to see or assess its performance. By doing so, it can also compare and contrast its performance with other companies or competitors. These standards also help a business see its strengths and weaknesses. By also comparing past and current performances, a business can assess the success of its strategies.

Businesses will either prosper or fall. Depending on the trends and the economy of the country, an investment may grow or go down the drain. But in the end, accounting standards will make a difference. That is why all businesses have to follow and strictly adhere to these accounting standards.

Accounting Standards Issued by the Institute of Chartered Accountants of India are as below:

Number of the Accounting Standard (AS)	Title of the Accounting Standard	Date from which Mandatory (Accounting Periods Commencing on or After)	Enterprises to which Applicable
AS-1	Disclosure of accounting policies	1-4-1993	All
AS-2 (Revised)	Valuation of inventories	1-4-1999	All
AS-3 (Revised)	Cash Flow Statement	1-4-2001	Level - I
AS-4 (Revised)	Contingencies and events occurring after the balance sheet date	1-4-1998	All
AS-5 (Revised)	Net profit or loss for the period, prior period items and changes in accounting policies	1-4-1996	Level - I
AS-6 (Revised)	Depreciation Accounting	1-4-1995	All
AS-7 (Revised)	Construction Contacts	1-4-2002	All
AS-8	Withdrawn and included in AS-26	—	—
AS-9	Revenue Recognition	1-4-1993	All
AS-10	Accounting for fixed assets	1-4-1993	All
AS-11 (Revised 2003)	The effects of changes in foreign exchange rates	1-4-2004	All
AS-12	Accounting for government grants	1-4-1994	All
AS-13	Accounting for investments	1-4-1995	All
AS-14	Accounting for amalgamations	1-4-1995	All

AS-15	Employees benefits	1-4-2006	All
AS-16	Borrowing costs	1-4-2000	All
AS-17	Segment reporting	1-4-2001	Level - I
AS-18	Related party disclosures	1-4-2001	Level - I
AS-19	Leases	1-4-2001	All
AS-20	Earning per share	1-4-2001	Level - I Refer AS-12
AS-21	Consolidated financial statements	1-4-2001	See Note 1
AS-22	Accounting for taxes on income	1-4-2001	For listed companies
		1-4-2002	Companies other than listed
		1-4-2006	See Note 2
		1-4-2002	All
AS-23	Accounting for investment in associates in consolidated financial statements		
AS-24	Discounting operations	1-4-2004	All
AS-25	Interim financial reporting	1-4-2002	Level - I
AS-26	Intangible assets	1-4-2003	Level - I
AS-27	Financial reporting of interests in joint ventures	1-4-2002	See Note I
AS-28	Impairment of asset	1-4-2004	Level - I
	Amendments	1-4-2006	Level - II
	Amendments	1-4-2008	Level - III
AS-29	Provisions, contingent liabilities and contingent assets	1-4-2004	All
AS-30	Financial Instruments — Recognition and Measurement	1-4-2011	Non-SMC
AS-31	Financial Instruments — Presentation	1-4-2011	Non-SMC
AS-32	Financial Instruments — Disclosure	1-4-2011	Non-SMC

1. AS-8 was withdrawn in pursuant to AS-26 becoming mandatory.
2. 29 accounting standards are issued as of date and only 28 are applicable
3. AS-30, AS-31, AS-32 are published but they will come into effect from 1.4.2009. It is mandatory on or after 1.4.2011.

AS-1: Disclosure of Accounting Policies

Effective date April 1993

This statements deal with the disclosures of significant accounting policies followed in preparing and presenting financial statements. The purpose of this statement is to promote preparing and presenting financial statements by instituting the disclosure of significant accounting policies in the financial statements and the manner of doing it.

The emphasis in AS-1 is on disclosure of accounting policies in the presentation of financial statements. These are normally to be disclosed at one place. All the companies now follow this practice. Accounting Polices refer to the specified accounting principles, adopted by the enterprise and methods of applying these principles in the preparation and presentation of financial statements. Some of the areas in which such disclosure is to be made are as under:

1. Methods of depreciation, depletion, and amortization.
2. Treatment of expenditure during construction
3. Valuation of inventories
4. Conversion or translation of foreign currency items
5. Treatment of goodwill
6. Valuation of investments
7. Valuation of fixed asset
8. Recognition of profits on long term contracts
9. Treatment of retirement benefits
10. Treatment of contingent liabilities

It is for the management to select the accounting policy to be followed by the enterprise. However, while making this selection, it is necessary to ensure that the financial statements present a true and fair view of the state of affairs. The major considerations to be followed during the selection of accounting policies are stated in AS-1 as under.

1. **Prudence:** This is a world of uncertainty. Profits are recognized only when realized. At the same time, provisions for all known liabilities and losses are made though the amount represents only the best estimate.
2. **Substance over form:** The accounting treatment and presentation of transactions and events in the financial statements should be governed by their substance and not just by the legal form. For example, the accounting of finance leases is based on the substance rather than the form of transaction. The lessee capitalizes the lease equipment as fixed assets being the owner in the substance, whereas the lessor records the investment made as debtor
3. **Materiality:** financial statements disclose all material facts. The IASC audit materiality as under:

"Information is material if its omission or misstatement could influence the economic decision of users taken on the basis of financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or mist statements. Thus materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic whose information should be there to be useful."

There are no hard and fast rules for determining materiality. Materiality is a matter of judgment. For instance, what is material to the financial statements of one firm may not be material to the financial statements of another firm of a different nature or size.

Why are Accounting Policies required to be disclosed?:

1. Accounting Policies means principles and methods to apply the principles adopted by the enterprise in the preparation and presentation of financial statements. Example, providing for depreciation is accounting principle and the methods are SLM, WDV or any other appropriate method.

2. The state of affairs and of the profit or loss can be significantly affected by the accounting policies followed. The need for disclosure of accounting policies arises because accounting policies may differ from enterprise to enterprise and for different years within the same enterprise. Accounting policies can differ in many areas, example:
   (a) Depreciation on Fixed Assets.
   (b) Valuation of Inventories.
   (c) Valuation of Investments.
   (d) Valuation of Fixed Assets.
   (e) Treatment of Foreign Currency Translations.
   (f) Treatment of Government Grants.
   (g) Treatment of Goodwill.
   (h) Treatment of Research and Development Costs.
   (i) Treatment of Retirement benefits
   (j) Recognition of Profit on Long-term Contracts.
   (k) Treatment of Contingent Liabilities, etc.

What are Fundamental Accounting Assumptions? Are they required to be disclosed in the financial statements?

Certain fundamental accounting assumptions underlie the preparation and presentation of financial statements. These accounting assumptions are assumed to have been followed in preparation of Financial Statements and need not be disclosed. If any of these fundamental assumptions are not followed, then this fact must be disclosed in the Financial Statements. The fundamental accounting assumptions are as follows;

1. **Going Concern/Concept of Continuity/Concept of Permanency:** According to this concept any business concern will continue to operate its activities for a fairly long time, *i.e.*, it will have a perpetual succession. It is assumed that the business enterprise has got no intention to close down its business activities. Continuing activity is the normal business process. Business enterprise will never assume its closure till the circumstances are such that closure becomes inevitable.
2. **Consistency:** The comparison of one accounting period with the other is possible only when the Consistency is followed. It means accounting from one accounting period to another should be on the same basis.
3. **Accrual:** Revenues and costs are accrued, *i.e.*, recognized as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate. The accrual concept forces the matching of revenues against relevant costs.

What are the Principles Governing selection of Accounting Policy?:

The overriding obligation to provide “True and Fair View” of the state of affairs of the enterprise is the major consideration in selection of Accounting Policies. Major points which are considered for the purpose of selection and application of Accounting Policies are:

1. Prudence (Conservatism): Prudence is the caution in the exercise of judgments when making estimates. According to this principle, business enterprise should consider all future losses but ignore all the anticipated profits. Profits should be considered only when it is actually realised. In other words, “Anticipate no profit but provide for all losses”. Example; inventory is valued at cost or Net Realizable Value, whichever is less.

2. Substance over Form: Economic reality of the transaction is important than the legal form for its accounting treatment and presentation in financial statements. Example, Assets purchased on hire purchase are shown in the books of Buyer in spite of the fact that the hire purchase buyer is not the legal owner.

3. Materiality: Financial statements should disclose all "material" information. Information is material if it can influence the decision of the user of financial statement or information is material if its omission or wrong statement could influence the economic decisions taken by the user based on such financial statements.

CAN ACCOUNTING POLICIES BE CHANGED?

Accounting policies can be changed if the change is required by statute or the change would result in more appropriate presentation of financial statement. If there is a change in accounting policies and such change affects the financial statement of current year or financial statements of later periods, then such change must be disclosed. The amount by which the financial statement is affected must also be disclosed to the extent ascertainable.

All significant accounting policies should be disclosed at one place and should form part of the financial statement.

The disclosure is not a remedy for an inappropriate treatment in the accounts.

Illustration 1

B.K.C. Ltd. prepared final accounts for the year 2012-13. During the year, accident took place in the factory. The worker who injured lodged a claim of ` 2,50,000 against the company. The case is pending in the court. The accountant did not disclose this in the accounts. Comment.

Solution

Claim for compensation pending in the court is a contingent liability. As per AS-1, it should be disclosed as a footnote to the final accounts. The company did not respect provisions of AS-1.

Illustration 2

ICICI Prudent Ltd. has sales of ` 500 crores in 2012-13. Cash sale of ` 500 was shown separately by the company. Comment.

Solution

As per AS-1, materiality convention should be followed. Cash sale of ` 500 in total sales of ` 500 crores is not material. It need not be disclosed separately.

Illustration 3

Lethargic Ltd. followed WDV Method of depreciation till 31st March, 2013. On 1st April, the company changed the method of depreciation to Fixed Instalment Method. The company did not disclose this is the notes. Comment.

Solution

As per AS-1, any change in the policy should be disclosed in the year in which the change is made. The company did not follow AS-1.

Illustration 4

ACC Ltd. prepared Profit & Loss Account and Balance Sheet for the year 2012-13. The accounting policies about Profit & Loss Account have been disclosed below Profit & Loss Account and accounting policies about Balance Sheet have been disclosed below Balance Sheet. Comment.

Solution

As per AS-1, the accounting policies adopted for preparation of final accounts should form part of final accounts. These policies should be disclosed at once place only forming part of account. It should not be disclosed separately.

Illustration 5

HCL Ltd. prepared Profit & Loss Account and Balance Sheet on cash basis. Comment.

Solution

As per AS-1, accrual basis is the fundamental accounting. The company follows cash basis, *i.e.*, records income when it is actually received and expenses when actually paid. If the accounting assumption is not followed, it should be disclosed in the form of a note to the accounts.

Illustration 6

Thakur Educational Trust sent a copy of Income & Expenditure Account and Balance Sheet for the year 2012-13 to all its members. Mr. Jitendra Singh, Managing Trustee of the Trust sent a separate letter to each member containing a note on the accounting policies followed for preparation of financial statements.

Comment on the above.

Solution

As per AS-1, accounting policies followed for preparation of financial statements should form part of final accounts. Separate letter about the accounting policies should not be sent. The policies should have been disclosed as a part of note to the final accounts.

Illustration 7

The finished goods inventory is valued at prime cost and at market value whichever is lower. Comment.

Solution

The policy is not as per AS-2.

Illustration 8

Draft the accounting policies to be disclosed in the financial statements for the following items:

(a) Revenue recognition – Sale of goods

(b) Depreciation

Solution

(a) Sales are recognized when goods are invoiced and dispatched to customers and are recorded inclusive of excise duty and net trade discount and sales tax.

(b) Depreciation is charged on straight line method as the rates specified in Schedule XIV of the companies act.

Illustration 9

The gross block of fixed assets are shown at cost of acquisition. It includes taxes, duties and other identified direct cost. Interest on borrowing to finance the fixed assets is not capitalized comment.

Solution

The policy appears to be correct.

AS-9: REVENUE RECOGNITION

Meaning and Scope

AS-9: Revenue Recognition is mandatory and applicable to all enterprises for accounting periods commencing on or after 1st April, 1993. Accounting standard explains when the revenue should be recognized in Profit & Loss Account and also states the circumstances in which revenue recognition can be postponed.

Revenue is gross inflow of cash, receivable or other consideration arising in the course of ordinary activities of the reporting entity from sale of goods, rendering of services, and from the use of entity’s resources by others yielding interest, dividend and royalties.

TRANSACTIONS EXCLUDED

Revenue recognition criteria as specified in Para 3 of AS-9 is not applicable to:

(i) Realised capital gains arising out of disposal of non-current assets and unrealized capital gains, *i.e.*, appreciation in the value of fixed assets;

(ii) Unrealized holding gains in the value of current assets,*i.e.*, increase in the market value of stock-in-trade;

(iii) Natural increase in the herds of livestock and agricultural and forest products;

(iv) Realised/unrealized gains arising out of fluctuations in foreign exchange rates and translation of foreign currency financial statements,

(v) Realized gains resulting from discharge of an obligation at a lesser amount than the carrying amount;

(vi) Unrealized gains resulting from restatement of the carrying amount of the obligation.

Timing of Revenue Recognition – Rendering of Services

Revenue from sale of rendering services should be recognized at the time of the sale or rendering of services. However, if at the time of rendering of services or sale there is significant uncertainty in ultimate collection of the revenue, then the revenue recognition is postponed. In such cases, revenue should be recognized only when it becomes reasonably certain that ultimate collection will be made. It also applies to the revenue arising out of escalation of price, export incentive, interest etc.

REVENUE FROM SALES OF GOODS

1. As per paras 10-11 of AS-9, revenue from sale of goods is recognized when the seller transfers the goods to the buyer for a consideration.

   Revenue is recognized when all the following conditions are fulfilled:

   (i) Seller has transferred the ownership of goods to buyer for a price.

   Or

All significant risks and rewards of ownership have been transferred to buyer.

(ii) Seller does not retain any effective control of ownership of the transferred goods.

(iii) There is no significant uncertainty in collection of the amount of consideration (*i.e*., cash, receivables etc.)

2. **Delivery delayed at buyer's request:** In some cases, the buyer may request for delayed delivery although he purchases the goods, takes the title and accepts billing. In such situations, sale is complete although physical delivery of the goods is delayed. Accordingly, revenue should be recognized and the inventory level should be reduced. It is prudent to disclose the value of goods held on behalf of the buyer as on the Balance Sheet date by way of note.

3. **Revenue Recognition when delivery of goods sold subject to conditions:**

(i) Installation and inspection: Revenue should be recognized when

(a) Goods are installed at the buyer's place to his satisfaction.

(b) Goods are inspected and accepted by the buyer.

(ii) Sale on approval: Revenue should be recognized when buyer confirms his desire to buy such goods by communication.

(iii) Guaranteed sales: In this case, revenue should be recognized as per the substance of the agreement of sale or after the reasonable period has expired.

(iv) Warranty sales: Sales should be recognized immediately but the provision should be made to cover unexpired warranty.

(v) Consignment sales: In this regard, revenue should be recognized only when the goods are sold to third party.

(vi) Special Order Shipments: Revenue from such sales should be recognized when the goods identified and ready for delivery.

(vii) Subscriptions for publication:

(a) Items delivered vary in value from period to period. Revenue should be recognized on the basis of sales value of items delivered.

(b) Items delivered do not vary in value from period to period. In this case, revenue should be recognized on straight-line basis over time.

(viii) Installment sales: Revenue of sale price excluding interest should be recognized on the date of sale. Interest should be recognized proportionately to the unpaid balance.

(ix) Revenue swaps: IAS-18 contains the provision for revenue swaps. However, no such corresponding provisions are given in AS-9. As per IAS-18, when goods or services are exchanged or swapped for goods or services, which are of a similar nature and value, the exchange is not regarded as a transaction, which generates revenue. However, when goods are sold or services are rendered in exchange for dissimilar goods, the exchange is regarded as a transaction, which generates revenue. Such revenue is measured at the fair value of the goods or service received, adjusted by the amount of any cash or cash equivalents transferred.

(x) Repo Arrangements: Under IAS-18, the recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole. For instance, a company may sell goods and, at the same time, enter into a separate agreement to repurchase the goods at a later date. Thereby the substantive effect of the

transaction is negated. In such a case, the two transactions are dealt with together. The AS-9 too in case of repo arrangements requires that such transactions should be recorded as financing arrangements. Therefore, the resulting cash inflow is not revenue and should not be recognized as revenue.

REVENUE FROM RENDERING OF SERVICES

Normally, revenue from service is recognized as the service is performed. The performance of service is measured by employing to methods:

1. **Completed Service Contract Method:** Revenue is recognized when service is about to be completed and significant uncertainties exist about the collection of amount of service charges.
2. **Proportionate Competition Method:** In this method, revenue is recognized by reference to the performance of each Act. Under this method, the revenue recognized is determined on the basis of contract value, associated cost, number of Acts or other suitable basis. Further, no significant uncertainty exists about the collection of amount of service charges of performed Acts.

Revenue Recognition Norms

The norms for revenue recognition for rendering of service under special condition are as follows:

1. **Installation Fees:** It is recognized when the installation is completed and it is accepted by the clients.
2. **Advertising and Insurance Agency Commission:** In this regards, the norms are as laid down under:
   (i) Advertising commission is recognized when the advertisement appears before public.
   (ii) Insurance commission is recognized on the effective commencement/renewal date of the policies.
3. **Financial Service Commission:** Revenue recognition of financial service commission is dependent upon:
   (i) Whether the service has been provided 'once and for all' or is on a continuing basis.
   (ii) The incidence of costs relating to the service.
   (iii) When the payment for the service will be received.

   As regards to commission charged for arranging or granting loan and other facilities, it should be recognized when a loan is sanctioned and accepted by borrower. Commitment facility or loan management fees that relate to continuing obligations or services, should normally be recognized over the life of the loan.
4. **Admission Fee:** Revenue from artistic performance, banquets and other special events should be recognized when event takes place.
5. **Tuition Fee:** Revenue should be recognized over the period of instruction.
6. **Entrance and Membership Fees:** Revenue recognition from entrance and membership fees depends upon the nature of service being provided. However, entrance fees are generally capitalized. Membership fees should be recognized on systematic and rational basis having regard to timing and nature of service provided.
7. **Revenue from Interest:** Revenue from interest should be recognized on time proportion basis.

8. **Revenue from Royalties:** Revenue from royalties is recognized on accrual basis as per terms of agreement.
9. **Revenue from Dividend:** Revenues from dividend is recognized when the declaring company declared dividend.

EFFECT OF UNCERTAINTIES (SUBSEQUENT UNCERTAINTY IN COLLECTION)

When uncertainty of collection of revenue arises subsequently after the revenue recognition, it is desirable to make provision for the uncertainty in collection rather than adjustment in already recognized revenue.

DISCLOSURE

1. When revenue recognition is postponed, the disclosure of the circumstances necessitating such postponement should be made.
2. Disclosure of Revenue from Sales Transactions (ASI-14):

   (i) Disclosure of Excise Duty in presentation of Profit & Loss Statement: As per ASI-14, the manner of disclosure of excise duty in the presentation of revenue from sales transactions (turnover) in the statement of profit and loss should be as given below:

	Turnover (Gross)	xx
Less:	Excise Duty	xx
	Turnover (Net)	xx

   (ii) Guidance Note on Revenue Recognition in Real Estate Sale: The term 'Real Estate' is meant by land as well as building. The issue is when should the revenue be recognized in case of real estate sales by the enterprises engaged in such activities (commonly referred to as 'real estate developers', 'builders' or 'property developers'.

   As regards to real estate, Revenue should be recognized when all the following conditions are fulfilled:

   (a) The seller has transferred to the buyer all significant risk and reward of ownership and the seller retain no effective control of the real estate transferred to a degree usually associated with ownership.

   (b) At the time of transfer of all significant risks and rewards of ownership, it is not unreasonable to expect ultimate collection.

   (c) No significant uncertainty exists regarding the amount of the consideration that will be derived.

   Once the seller has transferred all risks and rewards of ownership to the buyer and other conditions for recognition of revenue is satisfied, any further act in real estate performed by the seller are in substance, performed on behalf of the buyer in the manner similar to a contractor. Therefore, if the seller is obliged to perform any substantial acts after the transfer of significant risks and rewards of ownership, revenue is recognized by applying the percentage of completion method in manner as specified in AS-7, 'Construction Contract'.

Export Related Benefits such as DEPB

DEPB denotes Duty Entitlement Pass Book. The objective of DEPB is to neutralize the incidence of basic custom duty on the import content of the export products. The neutralization is provided by way of grant of credit against the export product.

In this regard, a recent ICAI opinion, the benefit of DEPB should be recognized in the year of export itself (provided no uncertainty exists). This is based on the matching concept. The activity of export results in an entitlement of DEPB credit and accordingly, this credit cannot be related to duty payable at the time of subsequent imports. At the time of subsequent imports, the full duty payable on such imports would form part of cost of purchase, which is paid partly, or fully by way of adjustment of DEPB credit. The export benefits should be booked separately as revenue by creating claim against it on the asset side. Accordingly, the cost of purchase of material subsequent to exports should be valued at full cost including the import duty saved, *i.e*., full custom duty should be loaded irrespective of its payment in cash or payment by utilization of DEPB credit. If DEPB credit is held for sale, the treatment of DEPB credit would be similar to the treatment when it is intended to be utilized for imports. However, significant uncertainty as regards to the amount of consideration realizable and uncertainty regarding its ultimate collection has to be taken into account.

Treatment of Inter-divisional Transfers

ICAI has announced that inter-divisional transfers/sales are not the revenue as per Accounting Standard-9 'Revenue Recognition'.

Since in case of inter-divisional transfers, risks and rewards remain within the enterprise and as there is no consideration from the point of view of the enterprise as a whole, the recognition criteria for revenue recognition are also not fulfilled in regard to inter-divisional transfers.

Illustration 10

Goods worth ` 10 lakhs are sent to Amritlal & Co. Ltd. by Sudhir & Co. Ltd. as per their order. Goods are delivered to them and communicated by Amritlal that goods are in order.

Comment on whether it should be recognized as revenue.

Solution

Yes, it should be recognized as revenue as it fulfilled all the conditions of sale of goods, which is complete in this respect. Against this sale, the amount of the sale is receivable. Hence, as per AS-9, it should be recognized as revenue.

Exercise

Neelkanth Publishers Co. Ltd. supplied the books of ` 5 lakhs to Narendra Book Stores Ltd. as per their order. Narendra Book Stores intimated to Neelkanth Publishers Co. Ltd. that the books are in order.

Comment on whether it should be recognized as revenue.

Illustration 11

Computers worth ` 5 lakhs are supplied to Maganlal & Co. Ltd. by Chhaganlal & Co. Ltd. on sale on approval basis.

Mention what AS-9 suggests in this respect. Should it be recognized as revenue?

Solution

As per AS-9, revenue should be recognized for sale on approval basis when the buyer confirms his desire to buy such goods by communication. In this, there is no communication from Maganalal & Co. Ltd. who are the buyers about their desire to buy the computers. Hence, no revenue should be recognized in this case. It will be recognized as revenue only after receipt of communication from Maganlal & Co. Ltd. indicating that they want to buy the computers, which were sent on sale on approval basis.

Exercise

Goods of ` 2 lakhs are sent to Abhijit & Co. for sale on approval.

Comment on whether revenue should be recognized and state answer as per AS-9.

Illustration 12

Goods of ` 300 are sent to Gambhir as advertising samples.

Comment on whether it should be recognized as Revenue as per AS-9.

Solution

In this case, refer solution to Illustration 1. No consideration is involved. Although goods are sent to Gambhir, they are sent as advertising samples free of charge for advertising purpose. Hence, there is no consideration in this case. Therefore, as per AS-9, no revenue can be recognized in this case.

Exercise

Goods of ` 500 are sent to Abhay as advertising samples.

Comment as to whether it will be recognized as Revenue as per AS-9.

Illustration 13

Abhay solds some goods to Abhijit without any consideration although goods are sent to Abhijit.

Offer your comment in this case on Revenue Recognition as per AS-9.

Solution

In this case, revenue will not be recognized. As per AS-9, it is clear that for revenue recognition the following conditions should be fulfilled:

(i) The seller has transferred the ownership of goods to buyer for price or All significant risks and rewards of ownership have been transferred to buyer.

(ii) The seller does not retain any effective control of ownership of the transferred goods.

(iii) There is no significant uncertainty in collection of the amount of consideration (*i.e.*, cash, receivables etc.).

In the above case, there is no consideration, hence there is no sale. Hence, revenue should not be recognized.

Exercise

Sanjay sells goods to Ajay without any consideration although goods are sent to Ajay.

Comment in this case on Revenue Recognition as per AS-9.

Illustration 14

Jai & Co. Ltd. have an order for ` 1 crore from Jayashree & Co. Ltd. Jai & Co. Ltd. have yet to execute the order.

Will this be recognized as revenue? What do the AS-9 suggest in this regard? What are the condition to be fulfilled for revenue recognition

Solution

It is mere receipt of an order and hence it is not a transaction of sale. The order is not even executed. Hence, no revenue can be recognized in this regard as per AS-9. The conditions to be fulfilled for sale of goods to be recognized as revenue are given under solution to Illustration 1.

Exercise

We have an order for ` 1 lakh from XYZ Co. Ltd. We have yet to execute the order.

Will this be recognized as revenue? What do the AS-9 suggest in this regard? What are the conditions to be fulfilled for revenue recognition?

Illustration 15

The Madanlal and Co. Ltd. have purchased the goods worth ` 5 crores. They have taken the title and accepted the billing from Tejas & Co. Ltd. But goods are not delivered to Madanlal and Co. Ltd. At their request.

In such a case, will the revenue be recognized? Comment with reference to AS-9.

Solution

Yes, in this case, the revenue from the sale will be recognized since all the conditions of revenue recognition from the sale of goods are fulfilled. Hence, the sale is complete although goods are not delivered to Madanlal & Co. Ltd. at their request. Therefore, as per AS-9, revenue recognition is correct.

Exercise

The Amritlal & Co. has purchased the goods worth ` 5 lakhs. The company has taken the title and accepted billing from us. But goods are not delivered to Amritlal by us.

In such a case, will the revenue be recognized? Comment with reference to AS-9.

Illustration 16

Indu Ltd. used certain resources of Priyanka Ltd. In return, Priyanka Ltd. received ` 25,00,000 and ` 30,00,000 as interest and royalties respectively from Indu Ltd. during the year 2012-13.

State whether and on what basis, the revenue can be recognized by Priyanka Ltd.

Solution

As per AS-9, revenue arising from use by other company resources yielding interest and royalties should be recognized only when no significant uncertainty exists.

Interest is recognized on time proportion basis and royalty is recognized on accrual basis. Interest is recognized in the year to which it pertains. It is not clear as to which year it belongs. Same is the case with royalty. If both pertains to 2006-07, it should be recognized during this year only.

Exercise

S & Co. used certain resources of P & Co. In return, P & Co. received ` 30,00,000 and ` 40,00,000 as interest and royalty respectively from S & Co. during the year 2012-13.

On what basis, the revenue can be recognized by P & Co.

Illustration 17

XYZ Ltd. has recognized ` 6,00,000 on accrual basis income from dividend on securities and units of mutual funds of the face value of ` 60 lakhs held by it as at the end of the year ending 31st March, 2013. The dividends were declared at the rate of 10% on 15th June, 2013. The dividend was proposed on 10th April, 2013 by the declaring company.

Comment.

Solution

The treatment is not as per AS-9. Dividend is recognized as income when the right to receive is established. In this case, right to receive is established on 15th June, 2013. Hence, dividend income should be recognized during the year 2013-14.

Exercise

Rajita Ltd. has recognized ` 12,50,000 on accrual basis income from dividend on shares of the face value of ` 50,00,000 held by the company at the end of the year ending 31st March, 2013. The dividends were declared at the rate of 25% on 1st July, 2007. The dividend was proposed on 15th May, 2013 by the company.

Is this treatment right as per AS-9?

Illustration 18

The directors of Rajashree Ltd. decided on 31st March, 2013 to increase the sale price of certain items retrospectively from 1st January, 2013. In view of the revision of price, the company has to receive ` 20 lakhs from its customers in respect of sales made from 1st January, 2013 to 31st March, 2013 and the accountant being inexperienced, cannot decide whether ` 20 lakhs due to price revision is revenue in the sale for 2012-13.

Give your suggestions.

Solution

The company stands to receive ` 20 lakhs due to price revision. If there is a certainty about collection, the revenue arising from price revision should be recognized in 2012-13.

Exercise

The directors of Monica Ltd. decided on 31st March, 2013 to increase the sale price of its products by 10% on sales taking place from 30th June, 2012 onwards. The intimation regarding the same was sent to all the customers by 15th June, 2012.

From which date, should the revenue pertaining to increase in sale price by 10% be recognized?

[**Hint:** Revenue will be recognized from 2012-13 provided there is a certainty that customers will accept the decision of the directors.]

Illustration 19

Installation fees of ` 5,00,000 are recognized as revenue by a company when the installation is completed at the buyer's place and goods are inspected and accepted by the buyer.

Comment on whether it is correct as per AS-9.

Solution

Revenue recognition in this respect is correct as the sale of services is complete as per AS-9.

Exercise

Installation fees of ` 1 lakh are recognized as revenue when the installation is completed.

Comment as per AS-9.

Illustration 20

Pfizer Ltd. 2002-03:

Revenue Recognition: Revenue from sale of goods is recognized when significant risks and rewards of ownership are transferred to the customers, which is at the point of dispatch of goods to the customers. Revenue from services is recognized on rendering of services. Interest income is recognized on time proportion basis.

Illustration 21

Ceat Ltd. 2002-03:

Sales are recognized on dispatch to customers. Sales include excise duty but exclude sales tax and freight recovery. Export incentives, Dividend and interest are accounted for on an accrual basis.

Illustration 22

Nicholas Piramal India Ltd. 2002-03:

The company recognizes sales at the point of dispatch of goods to the customer. Sales are net of discounts, sales tax, excise duty and returns.

Illustration 23

P C I Papers Ltd. 2002-03:

Revenue Recognition: Sales include exports sales, domestic sales, inter-division transfer, conversion income and net of returns, claims and discount allowed.

Domestic sales includes excise duty realized but net of sales tax.

Export sales includes the foreign exchange rate difference arising upon subsequent realization of invoices.

Benefits on account of entitlement of import duty free materials under the **'Duty Exemption Passbook Scheme'** is accounted for in the year of export.

Illustration 24

Dr. Reddy's Laboratories Ltd. 2002-03:

Revenue Recognition: Revenue from sale of goods is recognized when significant risks and rewards in respect of ownership of the products are transferred to the customer. Revenue from domestic sales of formulation products is recognized on dispatch of products to stockists by clearing and forwarding agents of the company. Revenue from domestic sales of active pharmaceutical ingredients and intermediates is recognized on dispatch of products from the factories of the company. Revenue from export sales is recognized on shipment of products.

Revenue from product sales is stated inclusive of excise duty and exclusive of returns, sales tax and applicable trade discounts and allowances.

Revenue from services is recognized as per the terms of the contracts with the customers when the services are performed.

Non-refundable up-front and milestone payments ("license fees") are recognized as revenue when earned, in accordance with the terms prescribed in the license agreements.

Dividend income is recognized when the unconditional right to receive the income is established. Income from interest on deposits and interest bearing securities is recognized on the time proportionate method.

Export entitlements under the Duty Entitlement Pass Book ("DEPB") scheme are recognized in the profit and loss account when the right to receive credit as per the terms of the scheme is established in respect of the exports made and where there is no significant uncertainty regarding the ultimate collection of the relevant export proceeds.

AS-6: DEPRECIATION ACCOUNTING (AS6)

Where an asset, *e.g.*, machinery, generates revenue over more than one accounting period, the matching principle demands that the cost of the asset be recognized over same number of accounting periods. Also, the allocation, as far as possible should be in the proportion of revenue generated by the asset. Depreciation for an accounting period is the cost of assets allocated to that accounting period. However, the allocated historical cost of an asset may not always reflect the appropriate charge against revenue. This can happen for example, when the asset has a terminal value or when the asset is revalued. For this reason, depreciation for an accounting period is regarded as amount of depreciable value allocated to an accounting period. The depreciable value is historical cost ± Change in historical cost due to revaluation or otherwise – terminal value expected on disposal of the asset.

The depreciation is a non-cash charge, *i.e.*, a charge of depreciation reduces profit available for distribution without reducing the available cash. The cash thus retained in the business is intended to be used for replacement of the depreciable asset. For this reason, Section 205 of the Companies Act 1956, provides that companies can pay dividend only out of profit available after charging depreciation in accordance with subsection 2 of that section. For the purpose, Schedule XIV of the Companies Act prescribes certain rates of depreciation. These are minimum rates of depreciation a company must charge.

Accounting standard 6, sets the broad principles for computation of depreciation without prescribing any specific rate or method of depreciation. Enterprises other than companies to which the standard applies, must compute and charge depreciation in accordance with the standard. In case of companies, the depreciation charged should be higher of (i) depreciation under Companies Act and (ii) depreciation as per AS-6.

AS-6 is mandatory in respect of accounting periods commencing on or after April 1, 1995. It applies to all enterprises.

Land has indefinite life and hence does not permit allocation of value over finite number of accounting periods. Hence, the standard does not apply to land, unless it has a limited useful life. The standard applies to all depreciable assets except the following to which special considerations apply:

(i) forests, plantations and similar regenerative natural resources

(ii) wasting assets including expenditure on the exploration for and extraction of minerals, oils, natural gas and similar non-regenerative resources

(iii) expenditure on research and development

(iv) livestock

Accounting Standard 6 defines depreciation as a measure of the wearing out, consumption or other loss of value of depreciable asset arising from use, efflux of time or obsolescence through technology and market changes. Depreciation is allocated so as to charge a fair proportion of the depreciable amount in each accounting period during the expected useful life of the asset. Depreciation includes amortization of assets whose useful life is predetermined.

"Depreciable assets" are assets which:

1. are expected to be used during more than one accounting period; and
2. have a limited useful life; and
3. are held by an enterprise for use in the production or supply of goods and services, for rental to others, or for administrative purposes and not for the purpose of sale in the ordinary course of business.

"Useful life" is Either

(a) the period over which a depreciable asset is expected be used by the enterprise; or

(b) the number of production or similar units expected to be obtained from the use of the asset by the enterprise.

"Depreciable amount" of a depreciable asset is its historical cost, or other amount substituted for historical cost in the financial statements, less estimated residual value. The depreciable amount of a depreciable asset should be allocated on a systematic basis to each accounting period during the useful of the asset.

The useful life of a depreciable asset should be estimated after considering:

(i) expected physical wear and tear

(ii) obsolescence and

(iii) legal or other limits on the use of the asset.

The useful lives of major depreciable assets or classes of depreciable assets may be reviewed periodically. Where there is a revision of the estimated useful life of an asset, the unamortized depreciable amount should be charged over the revised remaining useful life (Paragraph 23).

Example

A machine of cost ` 1,20,000 is depreciated straight-line assuming 10 year working life and zero residual value for three years. The estimate of remaining useful life after third year was reassessed at 5 years.

Depreciation per year charged for three years = ` 1,20,000/10 = ` 12,000

WDV of the machine at the end of third year = ` 1,20,000 – ` 12,000 × 3 = ` 84,000

Remaining useful life as per previous estimate = 7 years

Remaining useful life as per revised estimate = 5 years

Depreciation for the fourth year on wards = ` 84,000/5 = ` 16,800

Additions and Extensions (Paragraph 24)

(a) When an addition or extension retains a separate identity and is capable of being used after the existing asset is disposed off, depreciation should be provided independently on the basis of an estimate of its own useful life.

(b) Where an addition or extension becomes an integral part of an existing asset, it should be depreciated over the asset's remaining useful life. The depreciation on such addition or extension may also be provided at the rate applied to the existing asset.

Example

The estimated working life of a machine is 6 years. The machine is used with an attachment having a useful life of 10 years. The cost of the machine and that of the attachment are ` 60,000 and ` 6,000 respectively. The terminal value is zero for both. Straight line depreciation is in use.

Depreciation for the year:

(a) if the attachment retains a separate identity and is capable of being used after the machine is disposed off = ` 60,000/6 + ` 6,000/10 = ` 10,600

(b) if the attachment becomes an integral part of the machine = ` 66,000/6 = ` 11,000

Change in Depreciable Amount

(a) The historical cost of a depreciable asset may change due to increase or decrease in long-term liability on account of exchange fluctuations (See note), price adjustments, changes in duties or other similar factors. In these cases, depreciation on the revised unmortised depreciable amount should be provided prospectively over the residual life of the asset.

(b) Where the depreciable assets are revalued, the provision for depreciation should be based on the revalued amount and on the estimate of the remaining useful lives of such assets. In case the revaluation has a material effect on the amount of depreciation, the same should be disclosed separately in the year in which revaluation is carried out

The aforesaid two requirements ensure that no amortization of depreciable amounts remain pending after the assets cease to be useful. Since an asset does not generate any revenue after its useful is over, any amortization charged against revenue after such time, defeats the principle of matching revenue and costs.

Example

A machine of cost 1,20,000 is depreciated straight line assuming 10 year working life and zero residual value for three years. At the end of third year, the machine was revalued upwards by ` 6,000 the remaining useful life was reassessed at 9 years.

Depreciation per year charged for three years = ` 1,20,000/10 = ` 12,000

WDV of the machine at the end of third year = ` 20,000 – ` 12,000 × 3 = ` 84,000

Depreciable amount after revaluation = ` 84,000 + ` 6,000 = ` 90,000

Remaining useful life as per previous estimate = 7 years

Remaining useful life as per revised estimate = 9 years

Depreciation for the fourth year onwards = ` 90,000/9 = ` 10,000

Change in Method of Charging Depreciation

The depreciation method selected should be applied consistently from period to period. A change from one method of providing depreciation to another should be made only if the adoption of the new method is required by statute or for compliance with an accounting standard or if it considered that the change would result in a more appropriate preparation or presentation of the financial statements of the enterprise. When such a change in the method of depreciation is made, depreciation should be recalculated in accordance with the new method from the date of the asset coming into use.

The deficiency or surplus arising from retrospective recomputation of depreciation in accordance with the new method should be adjusted in the accounts in the year in which the method of depreciation is changed. In case the change in the method results in deficiency in depreciation in respect of past years, the deficiency should be charged in the statement of profit and loss. In case the change in the method results in surplus, the surplus should be credited to the statement of profit and loss. Such a change should be treated as a change in accounting policy and its effect should be quantified and disclosed.

Example

A company acquired a machine on 01/04/06 for ` 5,00,000. The company charged straight-line depreciation based on 10 year working life estimate and residual value ` 50,000 upto 2008-09. From 2009-10, the company decided to change to 20% reducing balance method of depreciation. Show adjustment required in books of the company.

Solution

Annual depreciation charged by the company upto 2008-09

= (` 5,00,000 – ` 50,000)/10 = ` 45,000

WDV of machine at the end of 2008-09 = ` 5,00,000 – ` 45,000 × 3 = ` 3,65,000

WDV of machine at the end 2008-09 (by reducing balance method)

= ` 5,00,000 $(1 – 0.20)^3$ = ` 2,56,000

Depreciation to be charged in 2009-10

= (` 3,65,000 – ` 2,56,000) + 20% ` 2,56,000 = ` 1,60,200

Books of the Company

		` 000	**` 000**
Depreciation	Dr.	160.2	
To Machine			160.2
Profit & Loss A/c	Dr.	160.2	
To Depreciation			160.2

Machine A/c

	` 000		**` 000**
To Balance b/d	365.0	By Depreciation	160.2
		By Depreciation	204.8
	365.0		365.0

Disclosures

1. The following information should be disclosed in the financial statements:
   (i) The historical cost or other amount substituted for historical cost of each class of depreciable assets;
   (ii) Total depreciation for the period for each class of assets and the related accumulated depreciation.

2. In addition to above, the following information should be disclosed in the financial statements along with the disclosure of other accounting policies:
   (i) Depreciation methods used; and
   (ii) Depreciation rates or the useful lives of the assets, if they are different from the principal rates specified in the statute governing the enterprise.
3. If any asset is disposed off, discarded the net surplus or deficiency; if material should be disclosed separately

AS-10: ACCOUNTING FOR FIXED ASSETS

After introduction AS-16, AS-19 and AS-26, provision relating to respective AS are held withdrawn and the rest is mandatory from the accounting year 1-4-2000.

This statement does not deal with accounting for the following items to which special considerations apply:

1. Forests, plantations and similar regenerative natural resources.
2. Wasting assets mineral rights, expenditure on the exploration for and extraction of minerals, oil, natural gas and similar non-regenerative resources.
3. Expenditure on real estate development.
4. Livestock.

Identification of Fixed Assets

Fixed assets is an asset held with intention of being used for the purpose of producing or providing goods or services and is not held for sale in the normal course of business.

Stand-by equipment and servicing equipment are normally capitalized. Machinery spares are usually charged to the profit and loss statement as and when consumed. However, if such spares can be used only in connection with an item of diced asset, it may be appropriate to allocate the total cost on a systematic basis over a period not exceeding the useful life of the principal item.

Components of Cost

Gross book value of a fixed asset is its historical cost or other amount substituted for historical cost in the books of account or financial statements. When this amount is shown net of accumulated depreciation, it is termed as net book value.

The cost of an item of fixed asset comprises it purchase price, including import duties and other non-refundable taxes or levies and any directly attributable cost of bringing the asset to its working condition for its intended use; any trade discounts and rebates are deducted in arriving at the purchase price.

The cost of a fixed asset may undergo changes subsequent to its acquisition or construction on account of exchange fluctuations, price adjustments, changes in duties or similar factors.

The expenditure incurred on start-up and commissioning of the project, including the expenditure incurred on test runs and experimental production, is usually capitalised as an indirect element of construction cost. If the interval between the date a project is ready to commence commercial production and the date at which commercial production actually begins is prolonged, all expenses incurred during this period are charged to the profit and loss statement.

Self-constricted Fixed Assets

Included in the gross book value are costs of construction that relate directly to the specific asset and costs that are attributable to the construction activity in general and can be allocated to the specific asset. Any internal profits are eliminated in arriving at such costs.

Example

ABC Ltd. is constructing a fixed asset. Following are the expenses incurred on the construction:

Materials	` 10,00,000
Direct Expenses	` 2,50,000
Total Direct Labour	` 5,00,000
(1/10th of the total labour time was chargeable to the construction)	
Total Office and Administrative Expenses	` 8,00,000
(5% is chargeable to the construction)	
Depreciation on the assets used for the construction of this assets	` 10,000

Calculate the cost of fixed assets.

Solution

Calculation of the Cost of Construction of Assets

Particulars	`
Direct Materials	1,000,000
Direct Labour	50,000
Direct Expenses	2,50,000
Office and Administrative Expenses	40,000
Depreciation	10,000
Cost of the Asset	1,350,000

Non-monetary Consideration

When a fixed asset is acquired in exchange for another asset, its cost is usually determined by reference to the fair market value of the consideration given. It may be appropriate to consider also the fair market value of the asset acquired if this is more clearly evident.

When a fixed asset is acquired in exchange for shares or other securities in the enterprise, it is usually recorded at its fair market value, or the fair market value of the securities issued, whichever is more clearly evident.

Fair market value is the price that would be agreed to in an open and unrestricted market between knowledgeable and wiling parties dealing at arm's length who are fully informed and are not under any compulsion to transact.

Improvements and Repairs

Any expenditure that increase the future benefits from the existing asset beyond its previously assessed standard of performance is include in the gross book value, *e.g.*, an increase in capacity.

The cost of an addition or extension to an existing asset, which has a separate identity and is capable of being used after the existing asset is disposed of, is accounted for separately.

Amount Substituted for Historical Cost

The revalued amounts of fixed assets are presented in financial statements either by restating both the gross book value and accumulated depreciation so as to give a net book value equal to the net revalued amount or by restating the the net book value by adding therein the net increase on account of revaluation.

Different bases of valuation are sometimes used in the same financial statements to determine the book value of the separate items within each of the categories of fixed assets or for the different categories of fixed assets. In such cases, it is necessary to disclose the gross book value included on each basis.

It is not appropriate for the revaluation of a class of assets to result in the book value of that class being greater than the recoverable amount of the assets of that class.

An increase in net book value arising on revaluation of fixed assets is normally credited directly to owner's interests under the heading of revaluation reserves and is regarded as not available for distribution. A decrease in net book value arising on revaluation of fixed assets is charged to profit and loss statement except that, to the extent that such a decrease is considered to be related to a previous increase on revaluation that is included in revaluation reserve.

Retirements and Disposals

Items of fixed assets that have been retired from active use and are held for disposal are stated at the lower of their net book value and net realizable value and are shown separately in the financial statements. Any expected loss is recognized immediately in the profit and loss statement.

On disposal of a previously revalued item of fixed asset, the difference between net disposal proceeds and the net book value is normally charged or credited to the profit and loss statement except that, to the extent such a loss is related to an increase which was previously recorded as a credit to revaluation reserve and which has not been subsequently reversed or utilized, it is charged directly to that account. The amount standing in revaluation reserve following the retirement or disposal of an asset which relates to that asset may be transferred to general reserve.

Hire Purchases

In the case of fixed assets acquired on hire purchase terms, although legal ownership does not vest in the enterprise, such assets are recorded at their cash value, which, if not readily available, is calculated by assuming an appropriate rate of interest. They are shown in the balance sheet with an appropriate narration to indicate that the enterprise does not have full ownership thereof.

Joint Ownership

Where an enterprise owns fixed assets jointly with others, the extent of its share in such assets, and the proportion in the original cost, accumulated depreciation and written down value are stated in the balance sheet. Alternatively, the pro rata cost of such jointly owned assets is grouped together with similar fully owned assets. Details of such jointly owned assets are indicated separately in the fixed assets register.

Goodwill

Goodwill, in general, is recorded in the books only when some consideration in. money or money's worth has been paid for it. As a matter of financial prudence, goodwill is written off over a period. However, many enterprises do not write off goodwill and retain it as an asset.

Patents

Patents are normally acquired in two ways: (i) by purchase, in which case patents are valued at the purchase cost including incidental expenses, stamp duty, etc. and (ii) by development within the enterprise, in which case identifiable costs incurred in developing the patents are capitalized. Patents are normally written off over their legal term of validity or over their working life, whichever is shorter.

Know-how

Know-how in general is recorded in the books only when some consideration in money or money's worth has been paid for it. Know-how is generally of two types relating to: (i) manufacturing processes and (ii) plans, designs and drawings of buildings or plant and machinery.

Know-how related to plans, designs and drawings of buildings or plant and machinery is capitalised under the relevant asset heads. In such cases, depreciation is calculated on the total cost of those assets, including the cost of the know-how capitalized. Know-how related to manufacturing processes is usually expensed in the year in which it is incurred.

Disclosure

1. Gross and net book values of fixed assets at the beginning and end of an accounting period showing additions, disposals, acquisitions and other movements;
2. Expenditure incurred on account of fixed assets in the course of construction or acquisition; and
3. Revalued amounts substituted for historical costs of fixed assets, the method adopted to compute the revalued amounts, the nature of any indices used, the year of any appraisal made, and whether an external valuer was involved, in case where fixed assets are stated at revalued amounts.

Example

On March 01, 2011, X Ltd. purchased ` 5 lakhs worth of land for a factory site. Company demolished an old building on the property and sold the material for ` 10,000. Company incurred additional cost and realized salvaged proceeds during the March 2011 as follows:

Legal fees for purchase contract and recording ownership	` 25,000
Title guarantee insurance	` 10,000
Cost for demolition of building	` 30,000

In March 31, 2011 Balance Sheet, X Ltd. should report a balance in the land account.

Solution

Calculation of the Cost for Purchase of Land

Particulars		`
Cost of Land		5,00,000
Legal Fees		25,000
Title Insurance		10,000
Cost of Demolition		
Less: Salvage value of Material	50,000	
Cost of the Asset	10,000	40,000
		5,75,000

3

CHAPTER

Introduction to IFRS and Accounting in Computerized Environment

INTRODUCTION

The Institute of Chartered Accountants of India (ICAI) has decided the strategy for adoption of IFRS in India with effect from 1st April, 2011. At present over 110 countries in the European Union, Africa, West Asia and Asia Pacific regions either or permit the use of IFRS. Even in the US there is on going debate about adoption of IFRS replacing the US GAAP. Now the International Accounting Standards Board (IASB) that issues IFRS and the Financial Accounting Standards Boards (FASB) that issues the US GAAP are cooperating and they have long-term and short-term projects to converge US GAAP into IFRS.

MEANING OF IFRS

IFRS represent sets of financial reporting standards issued by International Accounting Standards Board (IASB). This Board is independent standard setting body of International Accounting Standard Committee Foundation (IASC). In July 2005, IASC Foundation was formed. It constitutes team of 22 trustees from various countries.

FEATURES

1. IFRS is said be complied with only if this is an explicit statement of compliance with IFRS.
2. An entity should comply with each IFRS effective at the end of its first IFRS reporting period,
3. An entity is to do the following in the opening IFRS statement of financial position that it prepares as a starting point for its accounting under IFRS.
   (a) Recognize all assets and liabilities which are recognized by IFRS
   (b) Not recognize items as assets or liabilities if IFRS do not permit such recognition.
   (c) Reclassify items that it recognised under previous GAAP as per IFRS.
   (d) Apply IFRS in measuring all recognized assets and liabilities.
4. IFRS grants limited exemptions from these requirements.
5. IFRS requires disclosures that explain how the transition from previous GAAP to IFRS affected the entity's reported financial position.

OBJECTIVE

The objective of IFRS is to ensure that an entity’s first financial statements, and its interim financial reports contain high quality information which is:

1. Transparent for users
2. Provides a suitable starting point for accounting under IFRS.
3. Can be generated at a cost which does not exceed the benefits to users.

BENEFITS

Indian corporates are likely to reap significant benefits from adopting IFRS. European Union's experience highlights many benefits of adoption of IFRS. The important benefits are as follows:

1. Improvement in comparability of financial information and financial performance with global pears and industry standards.
2. IFRS enhances uniformity in the accounting principles.
3. Indian financial statements will be liked by foreign investors.
4. IFRS are expected to result in better quality of financial reporting.
5. Cost of raising funds in abroad will be lower.
6. It will lead to increased trust and reliance placed by Indian investors.
7. Better access and reduction in the cost of capital raised from global capital markets.

The above benefits will accrue only to the big corporates in India. The SME sector will not benefit much as they do not have necessary set up to cope with the problems that may arise by switching to the more rigorous IFRS.

Two separate sets of accounting standards under Sec. 211(3C) of the Companies Act have been agreed upon by the core group for convergence of Indian Accounting Standards with IFRS. For banking and insurance companies, there will be a separate road map. The core group committee of the government fma1ized the road map for IFRS convergence in India. The ICAI said that all the entities having net worth in excess of ` 1,000 crore will have to follow IFRS. The list includes all NSE and BSE listed companies, insurance entities, manual funds, venture capital funds and all scheduled banks having operations outside India.

CHALLENGES

There are several practical challenges in adoption of and full compliance with IFRS in India.

1. Several laws and regulations governing financial accounting and reporting in India need to be amended.
2. There are certain sections of the Companies Act that over ride the provisions on IFRS.
3. There is a shortage of professionals with practical IFRS conversion experience and therefore many companies will have to depend on external advisors and their auditors.
4. There is an urgent need, to build adequate IFRS skills among the Indian accounting professionals to manage the conversion.

INTERNATIONAL FINANCIAL REPORTING STANDARD (IFRS)

IFRS refers to the standard to be applied for reporting of financial statements. These lay down standards for reporting, presentation, carrying amounts and disclosure of financial statement.

There are references to IAS on some topics/issues. Till date 9 IFRS are issued. The details are as follows:

IFRS No.	Title
IFRS 1	First-time Adoption of International Financial Reporting Standards
IFRS 2	Share-based Payment
IFRS 3	Business Combinations
IFRS 4	Insurance Contracts
IFRS 5	Non-current Assets Held for Sale and Discontinued Operations
IFRS 6	Exploration for and Evaluation of Mineral Resources
IFRS 7	Financial Instruments: Disclosures
IFRS 8	Operating Segments
IFRS 9	Financial Instruments

INTERNATIONAL ACCOUNTING STANDARD (IAS)

IAS relates to standards, on various aspects of accounting issues. These are mainly relevant for maintenance of accounts as well as disclosure of information.

Till date 41 IAS have been issued, but 12 have been withdrawn. As on date, 29 IAS are in force.

IAS No.	Title
IAS 1	Presentation of Financial Statements
IAS 2	Inventories
IAS 7	Statement of Cash Flows
IAS 8	Accounting Policies, Changes in Accounting Estimates and Errors
IAS 10	Events after the Reporting Period
IAS 11	Construction Contracts
IAS 12	Income Taxes
IAS 16	Property, Plant and Equipment
IAS 17	Lease
IAS 18	Revenue
IAS 19	Employee Benefits
IAS 20	Accounting for Government Grants and Disclosure of Government Assistance
IAS 21	Effects of Changes in Foreign Exchange Rates
IAS 23	Borrowing Costs
IAS 24	Related Party Disclosures
IAS 26	Accounting and Reporting by Retirement Benefit Plans
IAS 27	Consolidated and Separate Financial Statements
IAS 28	Investments in Associates
IAS 29	Financial Reporting in Hyperinflationary Economics

IAS 30	Interests in Joint Ventures
IAS 32	Financial Instruments: Presentation
IAS 33	Earnings per Share
IAS 34	Interim Financial Reporting
IAS 36	Impairment of Assets
IAS 37	Provisions, Contingent Liabilities and Contingent Assets
IAS 38	Intangible Assets
IAS 39	Financial Instruments: Recognition and Measurement (To be replaced by IFRS 9)
IAS 40	Investment Property
IAS 41	Agriculture

INTERPRETATIONS ISSUED BY INTERPRETATION COMMITTEES (IFRIC/SIC)

Interpretations on application of IAS/IFRS are issued to provide guidance on relevant issues. This committee known as Standing Interpretations Committee (SIC) and renamed as International Financial Reporting Interpretation Committee (IFRIC)

The interpretations issued refer to applicable IAS/IFRS. Till date, 11 SIC Interpretation and 18 IFRIC Interpretation have been issued. These relate to specific IAS/IFRS

The adoption of, IFRS is inevitable for many nations, particularly when many enterprises have international/multinational associates/activities. This adoption requires convergence of local/national accounting standards with IFRS.

IASC Foundation has framed uniform/standardized procedures and time frame for convergence. Accordingly time frame commences on 1.4.2010. This requires preparing Opening Balance Sheet on 31.3.2010 as per Accounting Standard and prepare Reconciliation Statement which will explain difference between two standards – (i) 2011-12 will be the first IFRS reporting period and (ii) 31-3-2012 will be the first reporting date as per IFRS.

DEVELOPMENTS IN INDIA

In India, the ICAI decided to have convergence of AS issued by ICAI with IFRS in July 2007.

The Ministry of Corporate Affairs (MCA) constituted:

1. A Core Group
2. High-powered group supported by two subgroups.

The objective of these groups is to discuss and resolve implementation challenges.

The major areas covered by the groups related to:

1. Convergence of AS with IAS and IFRS. This needs analysis and comparison of two and thereafter revise various AS as per the requirement.
2. Identify changes required in various laws, regulations and as to converge with IFRS.

These Core groups issued press release as on 22-1-2010.

The group decided to have application of first stage of converged AS in three phases as follows:

	w.e.f.	Companies
Phase I	April 2011	Part of BSE – Senses 30 Part of NSE – Nifty 50 Listed Outside India Listed/Unlisted – Net worth over ` 1,000 crore
Phase II	April 2013	Listed/Unlisted – Net worth between ` 500 crore to ` 1,000 crore

SME are other entities not covered by mandatory implementation of IFRS. SMEs (Small and Medium Enterprises) refer to companies with turnover not over ` 100 crore or borrowing not over ` 25 crore.

Small enterprise is one where the investment in plant and machinery is more than ` 25,00,000 but less than ` 5 crore. A medium enterprise is one where investment in plant and machinery is more than ` 5 crore but less than ` 10 crore. Such companies are complied with requirements of IFRS for SME.

The ICAI has also taken measures to compare Accounting Standards issued in India with corresponding IAS and IFRS requirements. Based on comparison, steps are taken to revise as to meet the convergence requirements.

IFRS-1

The significant difference between Indian GAAP and IAS/IFRS is that the financial statements are prepared and presented as per historical cost concept and accrual method of accounting. IAS/IFRS requires presentation of various items in financial statements at fair value. Measurement assumes special significance as per IFRS. Fair Value represents transaction value on relevant date. Present value technique can be adopted to ascertain Fair Value.

To provide guidance to entity which adopts IFRS for first time, IASB has issued IFRS-1 which is titled as “First Adoption of IFRS”.

IFRS-1 provides that when an entity is required to comply with IFRS, it should prepare:

1. Statements of financial position at preceding date as per local GAAP.
2. Prepare reconciliation statement explaining changes in two approaches on the same date.
3. For next year, IFRS statements are prepared.
4. Thereafter, full-fledged IFRS compliant statements are to be prepared.

IFRS-1 also provides detailed guidance on preparation of financial statement with appropriate reference to IAS, IFRIC and SIC.

Accounting under IFRS

Accounting under IFRS Requires

1. Recognition of all assets and liabilities as per IFRS and not to recognize any other item not permitted under IFRS.
2. Reclassify items as per IFRS.
3. Apply IFRS for measurement of assets and liabilities.

This would require change in certain matters where cost of compilation is likely to exceed the benefits to the user. In such cases, compliance is optional.

Further, a concession is provided to small and medium sized entities (SME). For such entities, IFRS for SME is issued by IASB. IFRS for SME provides for omission of topics not related for SME and simplification of recognition and measurement of various items in Financial Statements.

The salient points specified in IFRS-1 are explained hereafter:

Financial Statements (under IFRS)

A complete set of Financial Statements comprises:

1. Statement of financial position as at the end of the year (Balance Sheet)
2. Statement of comprehensive income (Profit & Loss Account)
3. Statement of changes in equity (Appropriation)
4. Statement of cash flows
5. Notes, comprising, a summary of significant accounting policies and explanatory notes.

Features of Financial Statements

1. General Features:
   (a) Fair presentation
   (b) Going concern
   (c) Accrual basis of accounting
   (d) Materiality and aggregation
   (e) Consistency of presentation
   (f) Offsetting to achieve substance of the transaction or event – This indicates disclosure of net assets and liabilities as well as incomes or expenses.
   (g) Frequency of reporting – At least annually
   (h) Comparative information – Current and previous period
2. Title of the Statement to disclose:
   (a) Name of the entity – including changes
   (b) Whether single entity or group of entities is covered
   (c) Date and period covered
   (d) Presentation currency
   (e) Level of rounding off used
3. Presentation of financial statements should be in compliance with IFRS and IAS, as also interpretations developed by IFRIC and SIC.

Non-current Liabilities:

The liabilities other than the current liabilities are non-current liabilities.

The flowing are the examples of current liabilities:

(a)	Trade and other payable
(b)	Provision
(c)	Financial liabilities (excluding amounts shown under (a) and (b))
(d)	Liabilities and assets for current tax as defined in IAS-12 Income Taxes;

(e)	Deferred tax liabilities and deferred tax asset, as defined in IAS-12
(f)	Labilities included in disposal groups classified as held for sale in accordance with IFRS-5

Equity

Equity is the residual interest in the assets of the entity after deducting all its liabilities. Equity comprises:

(i) Equity Instruments

(ii) Share Premium (Share Issue Expenses to be deducted)

(iii) Retained Earnings and Reserve arising out of other comprehensive item.

Income

Income increases the economic benefits during the accounting period in the form of inflows or enhancements of assets or decrease of liabilities that result in increase in equity other than those relating to contributions from equity participants. Incomes are termed as:

(i) Total Comprehensive Income

Total comprehensive income as the change in equity during a period resulting from transactions and other events other than those changes resulting from transactions with owners in their capacity as owners. Total comprehensive income comprises of all components of profit or loss and of other comprehensive income.

(ii) Other Comprehensive Income

Other comprehensive income comprises of items of income and expenses (including reclassification adjustment) that are not recognized in profit or loss as required or permitted by other IFRSs. The components of other comprehensive income include:

1. Revaluation surplus
2. On translation of the financial statements of a foreign operations
3. Fair value remeasurement available for sale of financial assets
4. Actuarial gain or loss on defined benefit pension plans
5. The effective portion of gains and losses on hedging.

Expenses

Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrence of liabilities that result in decreases in equity other than those relating to distributions to equity participants.

Structure of Statement of Financial Position

Statement of Financial Position as at 31 ________ 2014

Particulars	2014	2013
ASSETS		
Non-current Assets		
Property, Plant and Equipment		
Goodwill		

Other Intangible Assets		
Investments in Associates		
Available for sale Investments		
Current Assets		
Inventories		
Trade Receivables		
Other Current Assets		
Cash and Cash Equivalents		
Total Assets		
EQUITY AND LIABILITIES		
Equity Attributable to the Owners		
Share Capital		
Retained Earnings		
Other Components of Equity		
Non-controlling Interest		
Total Equity		
Non-current Liabilities		
Long-term Borrowings		
Deferred Tax		
Long-term Provisions		
Total Non-current Liabilities		
Current Liabilities		
Trade and Other Payables		
Short-term Borrowings		
Current Portion of Long-term Borrowings		
Current Tax Payable		
Short-term Provisions		
Total Current Liabilities		
Total Liabilities		

However, liquidity based presentation is more appropriate for financial institutions. Even IAS-1 allows mixed basis of presentation, *i.e.*, some of the assets or liabilities are presented based on current non-current classification while others are presented on liquidity basis.

Structure of Statement of Comprehensive Income

Statement of Comprehensive Income for the year ended 31 ________ 2014

Particulars	**2014**	**2013**
Revenue		
Cost of Sales		
Gross Profit		

Other Income		
Distribution Costs		
Administrative Expenses		
Other Expenses		
Finance Costs		
Share of Profit of Associates		
Profit before Tax		
Income-tax Expense		
Profit for the Year from Continuing Operations		
Profit (loss) for the year from discontinued operations		
Profit for the year		
Other Comprehensive Income		
Exchange differences in translating foreign operations		
Gain (loss) on fair value changes in available for sale financial instruments		
Gain (loss) fair value changes in cash flow hedges		
Gain on revaluation property, plant and equipment		
Actuarial gain (loss) on defined: benefit pension plans		
Share of other comprehensive income of associates		
Income-tax relating to items of other comprehensive income		
Other Comprehensive Income Net of Tax		
Total Comprehensive Income of the Year		
Profit attributable to:		
Owners of the Equity		
Non-controlling Interest		
Total Comprehensive Income attributable to:.		
Owners of the Equity		
Non-controlling Interest		
Earning per Share		
Basic		
Diluted		

Notes:

1. An entity may present each item of other comprehensive income net of tax.
2. If the entity prefers to present each item of comprehensive income net of tax, it has to disclose in the notes the details as given below:

   Amount before tax

   Amount of tax

   Amount after tax
3. Computed on the basis of the profit for the year.

Fair Value

The fundamental basis of preparation arid reporting is that the statements should present fair presentation of financial position. It should satisfy qualitative characteristics such as:

1. Understandability.
2. Relevance.
3. Comparability.

The Fair Value as per IFRS and relevant IAS refer to the present realizable value of asset or liability. Thus, the statements have to be prepared at present realizable value and not at historical cost in relation to Non-current (*i.e.*, Fixed Asset/Investment).

This is a major departure from statement prepared in India, both per law (Companies Act) as well as Accounting Standard.

Several IFRSs require or permit entities to measure or disclose the fair value of the assets, liabilities or equity instruments. But IFRSs provide disparate and sometimes limited guidance on how to measure fair value.

The fair value of a financial liability with a demand feature (*e.g.*, a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

Fair value is the price that would be received on sale of an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

To ascertain fair value, appropriate technique should be applied considering the availability of information or data. Fair Value may be:

1. Observable market price.
2. Transaction price.
3. Present value of future cash flow.
4. Current replacement value.

Measurement of Fair Value

1. **Asset or Liability:** Fair value measurement is carried out for a particular asset or liability. The asset or liability might be a stand-alone asset or liability, or, a group of assets or liabilities.
2. **Orderly Transaction:** Fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date.

   An orderly transaction distinguishes a normal transaction from forced or distressed transaction. It is the transaction in which the asset or liability was exposed in the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities. It is not a forced transaction.

   The transaction shall occur in most advantageous market, after considering transaction costs and transport costs. This implies market where sell value of asset would be maximized and that of liability would be minimized.
3. **Market Participants:** To establish the fair value of an asset or a liability, it is not necessary to identify a specific market participant. It will rather consider the characteristics of market participants who will enter into the transaction to buy or sell a specific asset or liability in the most advantageous market.

They are buyers and sellers in the most advantageous market for the assets or liabilities that are:

(i) Independent of each other (not related parties),

(ii) Knowledgeable – Sufficiently informed to lack proper decision,

(iii) Able to enter into a transaction – The ability may be legal or intellectual,

(iv) Willing to enter into a transaction – Voluntary and not under compulsion or force.

4. **Price:** It is exit price on the measurement date which is either observable price or derived based on the characteristics of market participants. This normally represents transaction value at which asset or liability is transacted by parties except when participants (parties) are related.

   The price may be exit price or entry price.

5. **Application to Assets:** Fair value measurement is carried out taking into account a market participant's ability to generate economic benefit by using assets or by selling it to another market participant who will use the asset in its highest and best use. This would maximize the value of the asset considering various factors such as:

   (i) Physically possible,

   (ii) Legally permissible and

   (iii) Financially feasible.

INTRODUCTION TO COMPUTERIZED ACCOUNTING

By now, the students are familiar with the concepts of accounting and how different methods of accounting are to be adopted in different situations. We now look into accounting in a computerized environment. The first and foremost thing to remember is that the fundamentals of accounting does not change whether books of account are maintained manually or are computerized. The same principles of debit and credit that we apply for recording income or expenditure, purchase or sale of assets or creation or discharge of liability in a manual accounting system is equally applicable in a computerized environment. However, since the recording medium is something else compared to hard copy documents, and considerable reliance have to be placed on the software for the input, processing and output of the data certain precautions, methodologies and techniques are to be adopted while maintaining accounts in a computerized environment.

Meaning of Computerized Accounting

1. It captures business transactions in the form of accounting entries.
2. The accounting entries are then used to prepare financial statements
3. The financial statements are prepared based on accounting standards.
4. Various financial reports are prepared from the data available in the financial statements.

The above functions are performed by using a computer, the system so developed is called Computerized Accounting.

Salient Features of Computerized Accounting System

The main features of Computerized Accounting

1. **Speed:** Work done by the computers at a very high speed. Let us imagine the quantum of manpower required if 1,000 sales invoices are to be accounted daily and also to keep track of such sales, due date of receipt of money against the sale, money received in advance, etc.

With the help of computers, these things can be managed by a few people and in a shorter time.

2. **Accuracy:** Unlike people, machines do not make errors once they are programmed to work correctly. Thus, let us say a clerk is preparing a trial balance of an entity having 100 sales transactions daily and the trail balance does not tally. It would take days to find out the mistake. However, calculations done by machine are accurate and after all the transactions are fed into computer, the trial balance is ready within seconds after the completion of data feeding work.
3. **Various Informative Reports can be Generated:** In a computerized accounting system, it is possible in a manual system. Let us say a clerk is asked to prepare an area-wise list of sales from total sales throughout the year and the volume of sales transactions is about 500 a day. It would take the clerk or the accounts staff a few weeks to prepare such a statement. However, by using computers, such a statement can be prepared in a few minutes from the sales records by giving a few commands only.
4. **Economy:** Nowadays, computerized accounting has become cheaper as compared to human labour that has become more costly because of inflation. It is now economical to buy a computer and perform the accounting operations rather than employ a large number of people who would carry out the same job in a longer period.
5. **A Computerized System may be a Single Stand-alone Unit or a Multiple User, *i.e.*, LAN, WAN, etc.:** A computerized system may be a single machine containing software and operated by only a single user. It could also be several computer machines interconnected by LAN (Local Area Network), WAN (Wide Area Network)or other means such as telephone connections, satellites, etc., used by multiple users at the same time, in multiple user computer system, data can be proceed faster as more than one person is at work at the same time to complete the data feeding. In a computerized accounting system with multiple users, each user handles a particular segment of the transactions only, say, either sales, purchase, cash, bank, etc., and the ledger gets updated automatically based on the feedings done by all the users.

Computer information system environment exists when one or more computer(s) of any type or size is (are) involved in the processing of financial information, including quantitative data, of significance to the audit, whether those computers are operated by the entity or by a third party

A computerized accounting environment will therefore have the following salient features:

1. The processing of financial information will be by one or more computers.
2. The computer or computers may be operated by the entity or by a third party.
3. The processing of financial information by the computer is done with the help of one or more computer software, *e.g.*, tally.
4. A Computer Software includes any program or routine that performs a desired function or set of functions and the documentation required to describe and maintain that program or routine.
5. The computer software used for the accounting system may be acquired software or may be developed for the business.
6. Acquired software may consist of a spread sheet package or may be prepackaged accounting software. Larger organizations may use an Enterprise Resource Planning (ERP) package for:
   (a) Developing a customized accounting package is an option that some organisation prefers so as to suit the peculiarities of their business function.

(b) Outsourcing of the accounting system is also becoming popular where an organization is having the financial accounting processed from a third party.

Advantages of Computerized Accounting System

1. **Accurate, High Speed and Low Cost of Operation:** In a manual accounting system, special journals, subsidiary ledgers, etc., are used for recording accounting data. A computer-based system performs the accounting functions more rapidly, more accurately and (if the volume of repetitive transactions is large) at lower cost.
2. **Availability of Various Reports from the Same Accounting Data:** A computerized accounting system can generate as per instructions various reports in addition to the traditional balance sheet and profit and loss account. These reports that are generated as per requirements are useful for various purposes.
3. **Error free Accounting:** Computerized Accounting is error-free. A computer can perform millions of operations without committing any error unlike a human being.
4. **Automatic Completion of All Records by Feeding Only One Entry into the Computer:** In computerized accounting, once the initial feeding of the transactions is done in the computer, the entries set of accounts gets ready automatically. As required in manual accounting, there is no need to first write the subsidiary books, ledger, the general ledger, etc., and then prepare the financial statement.
5. **Multiple Set of Printouts Available:** Number of printouts with various modifications and including/excluding narrations can be taken and the data used more freely unlike manual system where there is only one set of accounts.

Disadvantages of Computerized Accounting System

1. **Requirement of Special Programme and Professional:** Special programs are required to enable the computer to carry out accounting operations that can be written only by programmers. Thus. Efficient computerized accounting system and its programs are sometimes costly.
2. **Qualified Staff Required for Operations**: Only a technically qualified person can operate a computer. Hence, the accounting staff has to be initially trained in a computer operations by a computer professional. This increases staff cost initially cost when there is a change from manual to computerized accounting.
3. **Costly Computer Peripherals and Stationery:** A computer requires various peripherals such as floppy disks for storage, printers, etc. and other special stationery items that are costly as compared to the traditional books of account.
4. **Regular Backup is Required as Data may be Lost for Various Reasons:** Regular backups on various storage devices such as hard disks, floppy disks, magnetic tape, etc. have to be taken to guard against possible loss of data. It is difficult to retrieve data lost from the computer due to inadvertence.
5. **Computer Viruses:** Data in a computer are subject to various risks including those by computer viruses. a computer viruses is a mischievous computer software written for fun/ frolic. It damages data inside a computer. A computer virus may destroy the entire data in a computer and those kept in a backup.

Terms Used In Computerized Accounting

The various terms used in computerized accounting and computer language are:

1. **Data:** Data mean any facts, observations, assumptions, or occurrences. In accounts, these would mean accounting entries to be passed to prepare financial statements and other related information e.g. in sales, invoices, details such as price, sales tax, date of sale, etc., are data.
2. **Record:** It consists of a group of data items related to an object of data processing, *e.g.*, sales register may be called record of sales invoices.
3. **Data File or File:** It is a compilation of related records maintained in some pre-arranged order. It is similar to manual files wherein various papers are stored. An example of a computer file would be a payroll file of 1,000 employees of an entity.
4. **System:** It means various components that process the data, *i.e.*, transactions/occurrences and give output, *i.e.*, results. It a manual accountings system, the components would be persons, books of account such as ledgers, cash book, etc. which gives results in the form of trail balance. In a computerized accounting system, it would mean the computer machine, the software program and computer peripherals such as keyboard monitor, etc

Significance of Computerized Accounting System

With computers becoming extensively used in business today, it is obvious that accounts which were earlier maintained in a manual form will be gradually replaced with computerized accounts.The speed with which accounts can be maintained is several fold higher. Basic difficulties faced like balancing of trial balance, correct posting into the general ledger and subsidiary ledger is a thing of the past. Today, any person maintaining accounts in the computer does not have to consider that while making say a cash expense entry through the cash payment screen that the corresponding ledger posting of the expense has been done properly or not. Similarly, the trial balance should automatically tally unless some mistake is made while recording the opening balances. The only concern that has increased today are concerns for controls, security and integrity of the computer system as more and more information is stored not in the hard print but as soft copies inside the computer. Issues like unauthorized access to the data either through the local area network or through the internet by hacking into the company server are becoming potential threat to the computer usage.

Pre-packaged Accounting Software

There are several pre-packaged accounting software which are available in the market and are used extensively for small- and medium-sized organizations. These softwares are easy to use, relatively inexpensive and readily available.

The installation of these softwares is very simple. An installation diskette or CD is provided with the software which can be used to install the software on a personal computer. A network version of this software is also generally available which needs to be installed on the server and work can be performed from the various workstations or nodes connected to the server.

Along with the software an user manual is provided which guides the user on how to use the software.

After installation of the software, the user should check the version of the software to ensure that they have been provided with the latest. The vendor normally provides regular updates to take care of the changes of law as well as add features to the existing software.

These softwares normally have a section which provides for the creation of a company. The name, address, phone numbers and other details of the company like VAT registration number, PAN and TAN numbers are feeded into the system. The accounting period has to be set by inserting the first and the last day of the financial year.

The next step in the use of this software could be the creation of accounts. This is done by adding the accounts along with their codes into the master files. Each account has to be classified into whether it is an asset or liability or an income or expenditure account. Whether the account has other subsidiary ledgers under it needs to be indicated to the system, the opening balances are to be entered into the master files. The company parameters need to be set at this point of time so that the accounts which are the cash, bank, sundry debtors, sundry creditors, etc. are known to the system. The customer's name, address and other basic details are also entered in the customer master file.

Similarly, the creditors details are entered into the creditor master file files. Product details are entered through the product master files. Here, the unit of measurement and the opening stock quantities including the values are provided. The system of valuation of stock like the FIFO, LIFO, Weighted average, etc. are defined in the product master files. Once the basic parameters are set and the master files are updated, the system is ready for use.

Once the basic parameters are set and the master files are updated, the system is ready for use.

Advantages of Pre-packaged Accounting Software

1. **Easy to Install:** The CD or floppy disk is to be inserted and the setup file should be run to complete the installation. Certain old DOS based accounting softwares required some settings to be added in the system configuration file and the system batch file. These instructions are generally provided in the user manuals.
2. **Relatively Inexpensive:** These packages are sold at very cheap prices nowadays.
3. **Easy to Use:** Mostly, menu-driven with help options. Further, the user manual provides most of the solutions to problems that the user may face while using the software.
4. **Backup Procedure is Simple:** Housekeeping section provides a menu for backup. The backup can be taken on floppy disk or CD or hard disk.
5. **Flexibility:** Certain flexibility of report formats provided by some of the softwares. This allows the user to make the invoice, challan, GRNs look the way they want.
6. **Very Effective for Small- and Medium-size Businesses:** Most of their functional areas are covered by these standardized packages.

Disadvantages of Pre-packaged Accounting Software

1. **Does Not Cover Peculiarities of Specific Business:** Businesses today are becoming more and more complex. A standard package may not be able to take care of these complexities.
2. **Does Not Cover All Functional Areas:** For example, production process may not be covered by most pre-packaged accounting software.
3. **Customization May Not be Possible in Most Such Softwares:** The vendors for these softwares believe in mass sale of an existing source. The expertise for customization may not have been retained by the vendor.
4. **Reports Generated is Not Sufficient or Serve the Purpose:** The demands for modern day business may make the management desire for several other reports for exercising management control. These reports may not be available in a standard package.
5. **Lack of Security:** Any person can view data of all companies with common access password. Levels of access control as we find in many customized accounting software packages are generally missing in a pre-packaged accounting package.

6. **Bugs in the Software:** Certain bugs may remain in the software which takes long time to be rectified by the vendor and is common in the initial years of the software.

EXERCISE

1. Define Computerized Accounting.
2. What are the salient features of Computerized Accounting?
3. Explain Computerized Accounting with its advantages and disadvantages.
4. Explain Codification and Grouping of Accounts with its classification in brief.
5. Write short notes on:
   (a) Maintaining the Hierarchy of Ledgers.
   (b) Consideration for Selection of Pre-packaged Accounting Software
6. What considerations should be taken during selection of accounting packages?
7. Explain Pre-packaged Accounting Software with its advantages and disadvantages in details.
8. Discuss the advantages and disadvantages of spreadsheet software as an accounting tool.
9. What do you mean by IFRS?
10. What are the features of IFRS?
11. Explain the benefits of IFRS.
12. What are the challenges posed by IFRS?
13. Give titles of IFRS.
14. What are the provisions of IFRS?
15. What are the features of financial statements as per IFRS norms?
16. What are the elements of financial statements?
17. Give the structure of of statements of financial position.
18. Give the structure of the statements of Comprehensive Income.
19. What is fair value measurement?
20. How would you measure fair value of liabilities?
21. What are the valuation techniques?
22. What is the process of first-time conversion to IFRS?
23. Give a checklist for first-time adoption IFRS.

Fill in the blanks with proper words

1. IFRS are issued by __________.
2. The date of implementation of IFRS is __________.
3. US GAAP are issued by __________.
4. IASC was formed on __________.
5. Till date, __________ IFRS are issued.
6. So far, __________ IAS are issued.
7. Interpretations on application of IFRS are issued by __________.
8. Till date __________ IFRI are issued.
9. The first reporting date as per IFRS __________.

10. The first reporting period as per IFRS is __________.
11. Investment in plant and machinery of small enterprises does not exceed __________.
12. Financial statements as per Indian GAAP are presented at __________.
13. Financial statements as per IFRS are presented at __________.
14. Fair value represents __________ value.
15. Current assets are expected to realize within __________ months.
16. Tangible assets are __________
17. Software is an __________ asset.
18. Living animal is a __________ assets.
19. Share premium is included in __________.
20. Fair value may be __________ value.
21. __________ increases the economic benefits.

[**Ans.** 1. IASB, 2. 1-4-2011, 3. FASB, 4. 1-7-2005, 5. 9, 6. 41, 7. IFRIC, 8. 18, 9. 31-3-2012, 10. 2011-2012, 11. ` 5 crores, 12. historical cost, 13. Fair value, 14. transaction, 15. 12, 16. non-current, 17. intangible, 18. biological, 19. equity, 20. market, 21. Income.]

Match the following

Group 'A'	Group 'B'
1. IFRS	(a) Date of implementation of IFRS
2. 1-4-2011	(b) Set of financial reporting standards
3. USGAP	(c) Investment on P&M not exceed ` 5 crore
4. IFRS	(d) FASB
5. Small enterprises	(e) Issued by IASB

[**Ans:** 1. (e), 2. (a), 3. (d), 4. (b), 5. (c).]

Group 'A'	Group 'B'
1. First Reporting da!e	(a) Begins on April 2011
2. First Reporting period	(b) Presented at fair value
3. First Phase	(c) Expected to realize with in 12 months
4. Financial statement as, per IFRS	(d) 2011-12
5. Current Assets	(e) 31.3.2012

[**Ans:** 1. (e), 2. (d), 3. (a), 4. (b), 5. (c).]

Group 'A'	Group 'B'
1. Non-current Assets	(a) Land & building
2. Software	(b) Biological asset
3. Property includes	(c) Equity
4. Living animals	(d) Intangible assets
5. Equity instruments	(e) Tangible assets

[**Ans:** 1. (e), 2. (d), 3. (a), 4. (b), 5. (c).]

State whether the following statements are True or False

1. IFRS are issued by ICAl.
2. IFRS are applicable to all the companies.
3. IFS will be adopted w.e.f. 1-4-2011.
4. US GAAP are issued by ICWAI.
5. The objective of IFRS is to have uniformity in financial statements.
6. IFRS will reduce cost of raising funds from global market.
7. IFRS are applicable to those enterprises which are having net worth in excess of ` 1,000 crore.
8. IASC was formed on 1st July, 2005.
9. AS on today these are 8 IFRS issued.
10. There are 21 IAS in force.
11. IFRIC is formed to issue interpretation of the IFRS.
12. So far, 18 IFRI are issued.
13. Time frame for convergence to IFRS commences on 1-4-2010.
14. The first reporting date as per IFRS is 31-3-2011.
15. The first phase of conversion begins in April 2011.
16. The enterprises having net worth in excess of ` 100 crore are small enterprises.
17. The enterprises having investment in plant and machinery not exceeding ` 5 crore are small enterprises.
18. AS per IAS, financial statements are presented at fair value.
19. AS per IFRS, financial statements are presented at historical cost.
20. Fair value represent average value.
21. Cash flow statement is not included in financial statements as per IFRS.
22. Current assets are expected to realize in 24 months.
23. Building is a biological assets.
24. Living animal is a biological asset.
25. Share premium is a part of equity.
26. Expenses increase the economic benefits.
27. Incomes decrease the economic benefits

[**Ans.** 1. False, 2. True, 3. True , 4. False, 5. True, 6. True, 7. True, 8. True, 9. False, 10. False, 11. True, 12. True, 13. True, 14. False, 15. True, 16. False, 17. True, 18. False, 19. False, 20. False, 21. False, 22. False, 23. False, 24. True, 25. True, 26. False, 27. False.]

Multiple Choice Questions

1. Following is an example of a non-monetary item __________.

   (a) Debtors (b) Creditors

   (c) Bank A/c (d) Stock

2. The mean rate exchange rates in force during a period is known as ___________.
   (a) Average rate (b) Closing rate
   (c) Reporting rate (d) none of the above
3. Reporting currency is the currency used for ___________.
   (a) Presenting financial statements (b) Recording financial transactions
   (c) Setting the financial transactions (d) None of the above
4. Non-monetary items are the items ___________.
   (a) Other than assets and liabilities
   (b) Assets and liabilities as other than monetary items
   (c) Exchanged at fair value
   (d) None of the above
5. Monetary items are the assets and liabilities ___________.
   (a) to be received or paid in money
   (b) to be received in fixed or determinable amount of money
   (c) to be received or paid in fixed amount
6. AS applicable for translation of foreign currency is ___________.
   (a) AS-11 (b) AS-13
   (c) AS-14 (d) AS-19
7. The amount of exchange difference is recorded in ___________.
   (a) Foreign Exchange Fluctuation A/c (b) General Reserve A/c
   (c) Profit and Loss A/c (d) None of the above
8. At the end of the year, the balance on Foreign Exchange Fluctuation A/c is transferred to ___________.
   (a) General Reserve A/c (b) Profit and Loss A/c
   (c) Balance sheet (d) None of the above
9. IFRS are issued by ___________.
   (a) IASB (b) ICAI
   (c) FASB (d) IASC
10. The ICAI has decided to adopt IFRS w.e.f. ___________.
   (a) 1-4-2012 (b) 1-4-2011
   (c) 1-4-2013 (d) 1-1-2011
11. US GAAP are issued by ___________.
   (a) ICAI (b) FASB
   (c) IASB (d) IASC.
12. The countries which have adopted IFRS are ___________.
   (a) Africa (c) Asia-Pacific Regions
   (b) West Asia (d) All of the above

13. IFRS are the ___________.
    (a) Sets of financial reporting standards
    (b) Rules of accounting
    (c) Sets of auditing standards
    (d) None of the above
14. The objective of IFRS is to ___________.
    (a) Ensure preparation of financial statements
    (b) Ensure that the financial statements contain high quality information
    (c) Ensure uniformity in financial statements at national level
    (d) None of the above
15. IFRS will facilitate ___________.
    (a) Better access and reduction in cost of capital raised from global market.
    (b) Easy borrowing from Indian capital market
    (c) Improvement in comparability of financial information.
    (d) Both (a) and (c)
16. IFRS are applicable to all the entities having net worth in excess of ` ___________.
    (a) ` 500 crore
    (b) ` 1000 crore
    (c) ` 100 crore
    (d) ` 10,000 crore
17. IASC was formed on ___________.
    (a) 1-1-2008
    (b) 1-7-2007
    (c) 1-7-2005
    (d) 1-4-2010
18. Till date, the IFRS issued are ___________.
    (a) 18
    (b) 9
    (c) 25
    (d) 5
19. The IAS issued so far are ___________.
    (a) 46
    (b) 45
    (c) 41
    (d) 51
20. As on today, the IAS in force are ___________.
    (a) 25
    (b) 21
    (c) 12
    (d) 29
21. The number of IAS withdrawn amounted to ___________.
    (a) 11
    (b) 15
    (c) 12
    (d) 18
22. Interpretations on application of IFRS are issued by ___________.
    (a) SIC
    (b) IFRIC
    (c) IASB
    (d) ICAI

23. Till date, the number of IFRI interpretations issued is ___________.
    (a) 12 (b) 18
    (c) 16 (d) 21
24. Time frame for convergence to IFRS commences on ___________.
    (a) 1-5-2010 (b) 1-4-2010
    (c) 1-10-2010 (d) 1-7-2010
25. The first reporting period as per IFRS is ___________.
    (a) 2009-10 (b) 2011-12
    (c) 2008-09 (d) 2012-13
26. The first reporting date as per IFRS is ___________.
    (a) 31-3-2011 (b) 31-3-2010
    (c) 31-3-2012 (d) 31-3-2013
27. The core group issued press release as on ___________.
    (a) 1-1-2010 (b) 22-1-2010
    (c) 25-1-2011 (d) 28-5-2010
28. The core group has decided to converge to IFRS in ___________.
    (a) 2 phases (b) 3 phases
    (c) 4 phases (d) 5 phases
29. The first phase begins on ___________.
    (a) May 2010 (b) April 2011
    (c) July 2011 (d) October 2010
30. The second phase begins on ___________.
    (a) May 2011 (b) March 2010
    (c) April 2013 (d) July 2011
31. SMEs are those organizations whose turnover does not exceed ___________.
    (a) 101 crore (b) ` 100 crore
    (c) ` 200 crore (d) ` 250 crore
32. Shakall Enterprises are those enterprises whose investment in plant and machinery does not exceed ___________.
    (a) ` 2 crore (b) ` 2.5 crore
    (c) ` 3 crore (d) ` 5 crore
33. Medium enterprises are those enterprises whose investment in plant and machinery is ___________.
    (a) More than ` 5 crore but less than ` 10 crore
    (b) More than ` 5.5 crore but less than ` 15 crore
    (c) More than ` 7.5 crore but less than ` 20 crore
    (d) More than ` 10 crore but less than ` 25 crore

34. Financial statements aas per IFRS are presented at __________.
    (a) Historical cost (b) Market value
    (c) Fair value (d) Replacement value
35. As per Indian GAAP, financial statements are presented at __________.
    (a) Market value (b) Historical cost
    (c) Fair value (d) Replacement value
36. Fair value represents __________.
    (a) Transaction value (b) Average value
    (c) Fair value (d) Replacement value
37. Financial statements as per IFRS include __________.
    (a) Balance Sheet (b) Profit & Loss A/c
    (c) Application A/c (d) All of the above
38. Financial statements as per IFRS include __________.
    (a) Cash flow statement (b) Summary of significant accounting policies
    (c) Balance Sheet & Profit & Loss A/c (d) All of the above
39. Presentation of financial statements should be in compliance with __________.
    (a) IAS
    (b) IFRS
    (c) IFRS, IAS and IFRIC interpretations
    (d) none of the above
40. Current assets are expected to realize within __________.
    (a) 12 months (b) 20 months
    (c) 24 months (d) 36 months
41. Non-current assets include __________.
    (a) Tangible assets (b) Intangible assets
    (c) Financial assets (d) All of the above
42. Intangible assets include __________.
    (a) Software (b) Website
    (c) Patent (d) All of the above
43. Property includes __________.
    (a) Freehold land (b) Building
    (c) Plant & equipment (d) Both (a) and (b)
44. Biological asset include __________.
    (a) Building (b) Machinery
    (c) Living animal (d) None of the above

45. Current liabilities are those liabilities which are to be settled with in a period of __________.
    (a) 18 months (b) 12 months
    (c) 21 months (d) 24 months
46. Equity comprises __________.
    (a) Equity instruments (b) Share premium
    (c) Retained earnings (d) All of the above
47. Incomes are __________.
    (a) Increases in the economic benefits (b) Decreases in the economic benefits
    (c) Decreases in cost (d) None of the above
48. Expenses are __________.
    (a) Increases in the economic benefits (b) Decreases in the economic benefits
    (c) Decreases in cost (e) None of the above
49. Fair value may be __________.
    (a) Market price (b) Transaction price
    (c) PV of future cash flow (d) All of the above
50. The approaches to fair valuation include __________.
    (a) In use valuation premise (b) In exchange valuation premises
    (c) Both (a) and (b) (d) None of the above
51. The methods of valuation include __________.
    (a) Market approach (b) Cost approach
    (c) Income approach (d) All of the above
52. While applying the PV techniques the factors to be considered include __________.
    (a) Risk (b) Uncertainty
    (c) Risk and uncertainty (d) None of the above
53. The process of conversion to IFRS include __________.
    (a) Initial phase (b) Planning
    (c) Execution (d) All of the above

[**Ans:** 1. (d), 2. (a), 3. (a), 4. (b), 5. (c), 6. (a), 7. (a), 8. (b), 9. (a), 10. (b), 11. (b), 12. (d), 13. (a), 14. (a), 15. (a), 16. (b), 17. (c), 18. (b), 19. (c), 20. (d), 21. (c), 22. (b), 23. (b), 24. (b), 25. (b), 26. (c), 27. (b), 28. (b), 29. (b), 30. (c), 31. (b), 32. (d), 33. (a), 34. (c), 35. (b), 36. (a), 37. (d), 38. (d), 39. (c), 40. (a), 41. (d), 42. (d), 43. (d), 44. (c), 45. (b), 46. (d), 47. (a), 48. (b), 49. (d), 50. (c), 51. (d), 52. (c), 53. (d)].

4 CHAPTER

Accounting Procedure

DOUBLE ENTRY BOOK-KEEPING SYSTEM

A double entry book-keeping system is a set of rules for recording financial information in a financial accounting system in which every transaction or event changes at least two different nominal ledger accounts.

The name derives from the fact that financial information used to be recorded using pen and ink in paper books — hence *"book-keeping"* (whereas now it is recorded mainly in computer systems) and that these books were called journals and ledgers (hence nominal ledger, etc.) — and that each transaction was recorded twice (hence *"double entry"*), with the two transactions being called a *"debit"* and a *"credit"*.

It was first codified in the 15th century by Luca Pacioli. In deciding which account has to be debited and which account has to be credited, the golden rules of accounting are used. In modern accounting, this is done using debits and credits within the accounting equation: Equity = Assets – Liabilities. The accounting equation serves as an error detection tool. If at any point the sum of debits does not equal the corresponding sum of credits, an error has occurred. It follows that the sum of debits and the sum of the credits must be equal in value.

Double entry book-keeping is not a guarantee that no errors have been made — for example, the wrong ledger account may have been debited or credited, or the entries completely reversed.

ACCOUNTING ENTRIES

The double entry accounting system records financial transactions in relation to asset, liability, income or expense related to it through accounting entries. Any accounting entry in the double entry accounting system will result in the recording of equal debit and credit amounts; that is, debits must equal credits. If the accounting entries are recorded without error, at any point in time the aggregate balance of all accounts having positive balances will be equal to the aggregate balance of all accounts having negative balances. The double entry book-keeping system ensures that the financial transaction has equal and opposite effects in at least two different accounts. Accounting entries use terms such as debit and credit to avoid confusion regarding the opposite effect of the accounting entry, *e.g.*, if an accounting entry debits a particular account, the opposite account will be credited and *vice versa*. The rules for formulating accounting entries are known as "Golden Rules of Accounting". The accounting entries are recorded in the "Books of Accounts". Regardless of which accounts and how many are impacted by a given transaction, the fundamental accounting equation A = L + OE will hold.

APPROACHES

There are two different approaches to the double entry system of book-keeping. They are Traditional Approach and Accounting Equation Approach. Irrespective of the two approaches, the effect on the books of accounts remain the same.

Traditional Approach

This approach is also called as the British Approach. Recording of business transactions under this method are formed on the basis of the existence of two aspects (debit and credit) in each of the transactions. Under the traditional approach, the transactions are entered in the books of accounts by following the golden rules of accounting. Under traditional approach, the accounts are classified based on their nature as real, personal and nominal accounts. After classifying the accounts, the following golden rules of accounting are applied to record the financial transaction:

1. **Personal Account:** Debit the receiver and credit the giver.
2. **Real Account:** Debit what comes in and credit what goes out.
3. **Nominal Account:** Debit all expenses and losses and credit all incomes and gains.

Accounting Equation Approach

This approach is also called as the American Approach. Under this approach, transactions are recorded based on the accounting equation, *i.e.*, Assets = Liabilities + Capital. The accounting equation is a statement of equality between the debits and the credits. The rules of debit and credit depend on the nature of an account. For this purpose of accounting equation approach, all the accounts are classified into the following five types based on periodicity of flow as: Assets Accounts, Capital Account, Liabilities Accounts, Revenues or Incomes Accounts and Expenses or Losses Accounts.

If there is an increase or decrease in one account, there will be equal decrease or increase in another account. There may be equal increases to both accounts, depending on what kind of accounts they are. There may also be equal decreases to both accounts. Accordingly, the following rules of debit and credit in respect of the various categories of accounts can be obtained. The rules may be summarized as below:

1. **Assets Accounts:** Debit increases in assets and credit decreases in assets.
2. **Capital Accounts:** Credit increases in capital and debit decreases in capital.
3. **Liabilities Accounts:** Credit increases in liabilities and debit decreases in liabilities.
4. **Revenues or Incomes Accounts:** Credit increases in incomes and gains and debit decreases in incomes and gains.
5. **Expenses or Losses Accounts:** Debit increases in expenses and losses and credit decreases in expenses and losses.

Illustration 1

Classify the following accounts according to Traditional and Modern approach:

1. Capital A/c, 2. Drawings A/c, 3. Building purchased, 4. Purchases A/c, 5. Sales A/c, 6. Carriage inward, 7. Carriage outward, 8. Cash received, 9. Cash paid, 10. Interest paid, 11. Interest received, 12. Commission paid, 13. Commission received, 14. Discount allowed, 15. Conveyance charges, 16. Sales promotion expenses, 17. Entertainment expenses, 18. Subscription paid, 19. Subscription received, 20. Light, power and electricity, 21. Telephone, postage and telegram, 22. Repairs incurred, 23. Insurance premium paid, 24. Bad debts written off, 25. Bad debts recovered, 26. Discount received, 27. Postage and stationery purchased, 28. F&F purchased, 29. Bank A/c,

30. Wages and salaries paid, 31. Travelling expenses, 32. Current A/c of the partner, 33. Loan A/c of a partner, 34. Sales return, 35. Bank Overdraft A/c, 36. Loan A/c of the partner, 37. O/s Salaries A/c, 38. Prepaid Rent A/c, 39. Interest Accrued A/c, 40. Interest received in advance.

Solution

According to Traditional Approach:

Personal A/c: 1, 2, 29, 32, 33, 35, 37, 38, 39, 40

Real A/c: 3, 8, 9, 28

Nominal A/c: 4, 5, 6, 7, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24, 25, 26, 27, 30, 31, 34, 36

According to Accounting Equation or Modern Approach:

Asset A/c: 3, 8, 9, 28, 29, 38, 39

Liabilities A/c: 33, 35, 37, 40

Capital A/c: 1, 2, 32

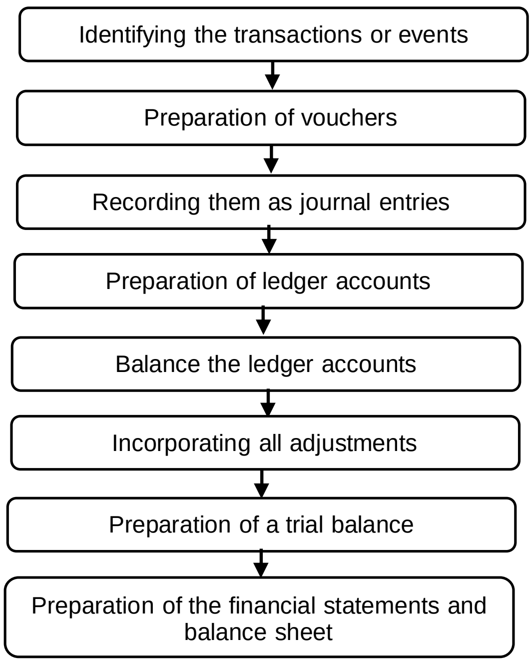
Revenue A/c: 5, 11, 13, 19, 25, 26, 34

Expenses A/c: 4, 6, 7, 10, 12, 14, 15, 16, 17, 18, 20, 21, 22, 23, 24, 27, 30, 31, 36

ACCOUNTING TRIAL

Accounting Trial is a sequential order in which the accounting process flows. All transactions are recorded first in a book called journal. The transactions are posted to the respective accounts, maintained in a separate book called ledger. Later, all adjustments such as opening entries, closing entries, adjusting entries are made in a book called journal proper and thereafter, the ledger balances are summarized to form a trial balance. From trial balance, trading account, profit and loss account and balance sheet are prepared.

Accounting trial is the process of:



Transactions and Events: A transaction is a business activity involving transfer of money or money's worth. It may be cash transaction or credit transaction. In cash transaction, cash flows immediately whereas in credit transaction, cash will be paid or received at future date. Assets acquired or sold, liabilities incurred or paid, expenses paid or payable, incomes received or receivable — are all business transactions. But there are events which are neither cash nor credit transactions but it has an impact on the financial position of a business. These events may include provision for bad debts, provision for repairs, depreciation, taxation, transfer of profit towards reserve fund or sinking fund or investment fluctuation fund, etc. Events happen as a result of internal policies or external needs. In accounting, transactions and events have equal relevance and they must be recorded to arrive at the financial results of the business concern.

Illustration 2

Analyze the following transactions according to traditional approach and modern approach:

(a) Subramanya started his business with cash
(b) Borrowed from Mahesh
(c) Purchased furniture
(d) Purchased furniture from Mohan on credit
(e) Purchased goods for cash
(f) Purchased goods from Ram on credit
(g) Sold goods for cash
(h) Sold goods to Shyam on credit
(i) Received cash from Shyam
(j) Paid cash to Ram
(k) Deposited into bank
(l) Withdrew cash for personal use
(m) Withdrew from bank for office use
(n) Withdrew from bank for personal use
(o) Received a cheque from a customer, Shyam at 5 pm
(p) Deposited Shyam's cheque next day
(q) Bank intimated that Shyam's cheque was dishonoured
(r) Paid Ram by cheque
(s) Paid salary
(t) Paid rent by cheque
(u) Goods withdrawn for personal use
(v) Paid an advance to suppliers of goods
(w) Received an advance from customers
(x) Paid interest on loan
(y) Paid installment of loan
(z) Interest allowed by bank

Solution

Analysis of Transaction under Traditional Approach

Sr. No.	Account Involved	Account Involved	Account Involved	Debit/ Credit
(a)	Cash A/c Capital A/c	Real Personal	Cash is coming in Subramanya is the giver	Debit Credit
(b)	Cash A/c Loan from Mahesh A/c	Real Personal	Cash is coming in Mahesh is the giver	Debit Credit
(c)	Furniture A/c Cash A/c	Real Real	Furniture is coming in Cash s going out	Debit Credit
(d)	Furniture A/c Cash A/c	Real Personal	Furniture is coming in Cash is going out	Debit Credit
(e)	Purchase A/c Cash A/c	Nominal Real	Purchase is an expense Cash is going out	Debit Credit
(f)	Purchase A/c Ram's A/c	Nominal Personal	Purchase is an expense Ram is the giver	Debit Credit
(g)	Cash A/c Sales A/c	Real Nominal	Cash is coming in Sales is a revenue	Debit Credit
(h)	Shyam's A/c Sales A/c	Personal Nominal	Shyam is the receiver Sales is a revenue	Debit Credit
(i)	Cash A/c Shyam's A/c	Personal Nominal	Cash is coming in Shyam is the giver	Debit Credit
(j)	Ram's A/c Cash A/c	Personal Real	Ram is the receiver Cash is going out	Debit Credit
(k)	Bank A/c Cash A/c	Personal Real	Shyam is the receiver Cash is going out	Debit Credit
(l)	Drawings A/c Cash A/c	Personal Real	Subramanya is the receiver Cash is going out	Debit Credit
(m)	Cash A/c Bank A/c	Real Personal	Cash is coming in Bank is the giver	Debit Credit
(n)	Drawings A/c Bank A/c	Personal Personal	Subramanya is the receiver ank is the giver	Debit Credit
(o)	Cash A/c Shyam's A/c	Real Personal	Cash (Cheque) is coming in Bank is the giver	Debit Credit
(p)	Bank A/c Cash A/c	Personal Real	Bank is the receiver Cash (Cheque) is going out	Debit Credit
(q)	Shyam's A/c Bank A/c	Personal Personal	Shyam is the receiver Bank is the giver	Debit Credit
(r)	Ram's A/c Bank A/c	Personal Personal	Ram is the receiver Bank is the giver	Debit Credit

(s)	Salary A/c Cash A/c	Nominal Real	Salary is an expense Cash is going out	Debit Credit
(t)	Rent A/c Bank A/c	Nominal Personal	Rent is an expense Bank is the giver	Debit Credit
(u)	Drawings A/c Purchase A/c	Personal Nominal	Subramanya is the receiver Decrease in stock	Debit Credit
(v)	Advance to Suppliers A/c Cash A/c	Personal Real	Suppliers are the receiver Cash is going out	Debit Credit
(w)	Cash A/c Advance from Customers A/c	Real Personal	Cash is coming in Customers are the giver	Debit Credit
(x)	Interest on Loan A/c Cash A/c	Nominal Real	Interest is expense Cash is going out	Debit Credit
(y)	Loan A/c Cash A/c	Personal Real	Lender is the receiver Cash is going out	Debit Credit
(z)	Bank A/c Bank Interest A/c	Personal Nominal	Bank is the receiver Bank interest is an income	Debit Credit

Accounting Equation

The preparation of balance sheet is the final step in accounting process. The accounting equation indicates that the sources of funds should be equal to uses of funds. In other words, proprietor's equity and liabilities to outsiders should be equal to assets.

Sources of Funds = Applications of Funds OR

Owner's Equity = Assets OR

Owner's Equity + Outside Liabilities = Assets

$A = L + P$

$L = A - P$

$P = A - L$

$A - L - P =$ Zero, where, L is liabilities, P is Proprietor's equity and A is Assets.

Steps Involved in Developing Accounting Equation

1. Ascertain the variables (assets, liabilities or capital) of an equation affected by the transaction.
2. Find out the effect (in terms of increase or decrease) of a transaction on the variables of the equation.
3. Show the effect on the appropriate side of an equation.

Illustration 3

Transaction 1: Started business with ` 1,00,000

Variable Affected	Asset and Capital
Effect of the transaction	Increase in assets and capital
Accounting equation	Assets = Liabilities + Capital 1,00,000 = 0 + 1,00,000

Transaction 2: Purchased goods for cash ` 20,000.

Variable Affected	Asset and Capital
Effect of the transaction	Increase in assets (stock) and Decrease in another asset (cash)
Accounting equation	Assets = Liabilities + Capital – 20,000 + 20,000 = 0 + 0

Transaction 3: Sold goods costing ` 10,000 for cash ` 12,000.

Variable Affected	Asset and Capital
Effect of the transaction	Increase in assets (cash) and Decrease in another asset (stock) and increase in capital
Accounting equation	Assets = Liabilities + Capital – Stock + Cash – 10,000 + 12,000 = 0 + 2,000

Illustration 4

Show what accounts are affected in the following transactions. Also show the accounting equation for the transactions.

1.	Madan commenced business with cash	` 70,000
2.	Purchased goods on credit	` 14,000
3.	Withdrew for private use	` 3,000
4.	Goods purchased for cash	` 12,000
5.	Paid wages	` 5,000
6.	Paid to creditors	` 10,000
7.	Sold goods on credit (cost price ` 18,000)	` 22,000
8.	Sold goods for cash (cost price ` 3,000)	` 6,000
9.	Purchased furniture for cash	` 5,000
10.	Received from debtors	` 11,000

Solution

Analysis of Transaction under Traditional Approach

Transaction No.	Accounts Affected in the Books of the Business	Account to be Debited and Account to be Credited
1	Capital account and Cash account	Cash account being real account is debited and Capital account being personal account is credited
2	Goods account and Creditors account	Goods account being real account is debited and Creditors account being personal account is credited
3	Personal Drawings account and Cash account	Drawings account being personal account is debited and Cash account being real account is credited
4	Goods account and Cash account	Cash account being real account is debited and Cash account being real account is credited
5	Wages account and Cash account	Wages account being nominal account is debited and Cash account being real account is credited

6	Cash account and Creditors account	Creditors account being personal account is debited and Cash account being real account is credited
7	Goods account, Debtors account and Profit account	Debtors account being personal account is debited, profit transferred to capital account being personal account is credited and goods account being real account is also credited
8	Furniture account and Cash account	Furniture account being real account is debited and Cash account being real account is credited
9	Cash account and Debtors account	Cash account being real account is debited and Debtors account being personal account is credited

Accounting Equations for the Transactions

Trans-action No.	**Assets =**			**Liabilities + Owner's Equity**		
	Cash (+)	**Goods (+)**	**Debtors (+)**	**Furniture (+)**	**Creditors (+)**	**Madan's Capital**
01	70,000					7,000
02		14,000			14,000	
03	–3,000					–3,000
04	–12,000	+12,000				
05	–5,000					–5,000
06	–10,000				–10,000	
07		–18,000	22,000			+4,000
08	+6,000	–3,000				+3,000
09	–5,000			5,000		
10	+11,000		–11,000			
End equat-ion	52,000+	5,000+	11,000+	5,000+	4,000+	69,000
				=73,000		**=73,000**

SUBSIDIARY BOOKS

Journal is a book of original entry and only one journal is maintained if the business is very small in size and the transactions are limited. However, if the transactions are multifarious, then subsidiary books which are known as books of original entry are prepared. The types of subsidiary books include:

- **(a) Purchase Book:** To record all credit purchases of goods only.
- **(b) Sales Book:** To record all credit sales of goods only.
- **(c) Purchase Return Book:** To record goods returned to suppliers out of credit purchase.
- **(d) Sales Return Book:** To record goods returned by customers out of credit sales of goods.
- **(e) Cash Book:** To record all cash transactions only.

(f) **Analytical Petty Cash Book:** To record petty payments.

(g) **Bills Receivable Book:** To record all bills of exchange which are received from debtors.

(h) **Bills Payable Book:** To record all bills of exchange accepted and given to creditors.

(i) **Journal Proper:** It is used to record only those business transactions which cannot be entered in any of above eight books.

INTRODUCTION/ORIGIN OF SUBSIDIARY BOOK

In earlier stage (times), businessmen used only one Journal for recording all the business transactions. '*Journal*' as a book of accounts was convenient because the volume of business was small and the number of transactions are very few. But with the growth of business, the number of transactions increased and need was felt for better method of recording transactions. If all these business transactions recorded in one and the same journal, the journal would be bulky. Moreover, it is impossible for many clerks to work on the same journal at one and the same time. Under such situation, it becomes necessary to divide the whole Journal into several subsidiary journals so that work can be assigned to many at one and the same time. In each separate journal, one particular class of business transactions is recorded.

'*Journal*' and '*Subsidiary books*' are the books of original entry or books of prime entry. In a small business, transactions are few and therefore, only one book is maintained, *i.e.*, Journal. On the other hand, in a big business, number of transactions are large and therefore, one book is not enough to record all the transactions and therefore subsidiary books maintained.

Types of Journal

General Journal (Journal)	**Special Journal (Subsidiary books)**
1. Small scale operation	1. Large scale operation
2. Few transactions	2. Daily transactions are large in number
3. Transactions not repetitive in nature	3. Transactions are repetitive in nature
4. Engaged in providing services *e.g.*, Tax consultant, Legal consultant, Tutorial classes etc.	4. Engaged in buying and selling goods *e.g.*, Manufacturers, Wholesalers, Retailers, etc.

Needs of Subsidiary Books

The need of subsidiary books is as follows:

1. **Division of Work:** Since Journal is divided into number of books, it facilitates division of work among clerks thereby avoiding overburdening clerks.
2. **Specialization:** When a person a assigned same type of work, it will lead to specialization and increased efficiency.
3. **Time Saving:** Since the work and responsibility is divided among a number of people, various accounting processes can be undertaken simultaneously which helps in saving time.

4. **Ready Information:** When separate books are kept for each type of transaction, the information relating to each transaction is readily available.
5. **Effective Internal Audit:** Subsidiary books, due to its effective design, helps in achieving effective internal audit or check.

MEANING

Subsidiary books are nothing but subdivision of journal. A subsidiary book is a divided part of journal meant for recording specific types of business transactions. *Subdivided books (journal) on the basis of nature of transactions like sales, purchases etc. are called subsidiary books.*

When a journal is divided into many sub-parts, each of those sub-parts is called as subsidiary books. Subsidiary books are also known as the books of original entry or prime entry because transactions are first recorded in Subsidiary books and then posted to the ledger.

Types of Subsidiary Books

In order to meet the requirement of modern business, the original journal is divided into the following:

1. Purchase Journal (Book)
2. Sales Journal (Book)
3. Purchase Return Journal (Book)

   OR

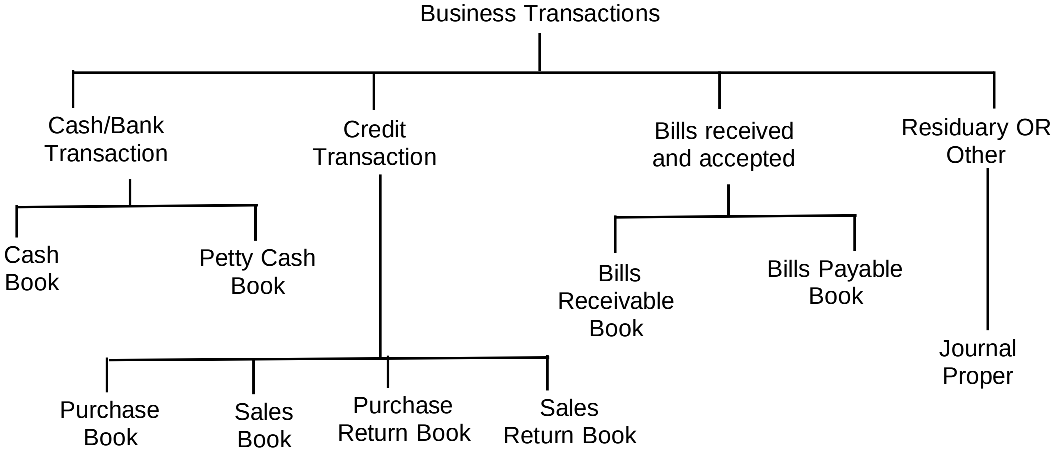
   Return Outward Journal (Book)
4. Sales Return Journal (Book)

   OR

   Return Inward Journal (Book)
5. Cash Journal (Book)
6. Bills Receivable Journal (Book)
7. Bills Payable Journal (Book)
8. Journal Proper

Advantages of Subsidiary Books

1. Many clerks can be employed at one and the same time in writing different journals.
2. It saves time and energy as work is reduced.
3. It helps to have internal check more effectively.
4. It makes the work simple and therefore, all the persons appointed need not be with high qualifications.
5. Each subsidiary book becomes handy. Therefore, it can be carried to any place at any time.
6. The transactions are grouped and classified which helps in proper analysis.
7. It facilitates easy reference.
8. More details of business transactions can be recorded in subsidiary books and this is not possible in the Journal.
9. The ledger clerk can do ledger posting at his convenience.
10. Two/three auditors can simultaneously audit the records.



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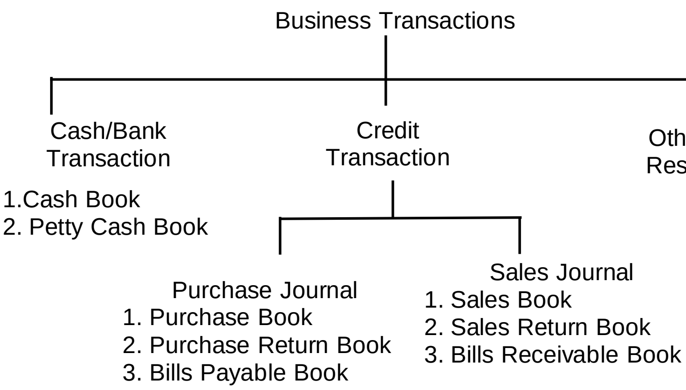


Sr. No.	Subsidiary Books	Source Document OR Basis of Writing the Subsidiary Books OR Documentary Evidence	Nature of Business Transaction OR Category of Business Transaction Recorded
1	Purchase Book	Inward Invoice/Bill/Credit memo	Credit purchase of goods only
2	Sales Book	Outward Invoice/Bill/Credit memo	Credit sales of goods only
3	Purchase Return Book (Return Outward book)	Debit Note	Return of goods purchased on credit
4	Sales Return Book (Return Inward Book)	Credit Note	Return of goods sold on credit

5	Cash Book	Receipts issued, receipts received, Cash memos issued, Cash memos received, Vouchers, Pay-in-slips, cheques, Pass Book, Advice and Statement received from Bank	All cash and bank transactions
6	Bills Receivable Book (not in syllabus)	All bills received by us OR Duly accepted bill received from Customers (Debtors/Drawee)	All bills received by us OR Bills accepted by customers
7	Bills Payable Book (not in syllabus)	All bills accepted by us OR Duly accepted bill sent to suppliers (Sellers/Creditors/Drawer)	All bills accepted by us OR Bill of suppliers accepted by us
8	Journal Proper	Depends on the type of transaction	All the other transactions which cannot be entered in the above subsidiary book.

GOODS JOURNAL

It is divided into: (i) Purchase Book, (ii) Sales Book, (iii) Purchase Return Book and (iv) Sales Return Book. It is also known as proper subsidiary book. To record a transaction in the proper subsidiary books, the main conditions are:

1. It should be a credit transaction.
2. It should be a transaction of goods.

If only one condition is satisfied, then that transaction cannot be entered in Goods Journal.

Both the conditions should be satisfied to enter a transaction in the proper subsidiary books.

Examples:

1. Goods sold to Mahesh and cash received, (Here, it is a goods transaction; but it is not a credit transaction.)
2. Purchased Plant & Machinery from Kamesh on credit, (This is a credit transaction, but it is not relating to goods.)
3. Furniture sold to Haresh on cash basis. (It is neither a credit transaction nor relating to goods.)

1. Purchase Book

This is the book of prime entry which records all transactions of credit purchases of goods.

In this book, all the goods purchased on credit are recorded. Furniture or Machinery purchases on credit or goods purchase for cash etc. are not entered in the purchase book.

This book is maintained mainly to record credit purchases of goods in business. A transaction to find place in purchase book must comply two necessary conditions: (i) it should be credit transactions and (ii) it must involve purchase of *"Goods"* only. Cash purchases of goods are recorded in the Cash Book. Credit purchase of assets are recorded in the Journal Proper.

A Purchase Book is also known as Purchase Journal, Invoice Book, Purchase Register, Bought Book, Purchase Day Book etc.

Basis of Writing a Purchase Book

Invoice or Bill or Credit Memo is the basis of writing a Purchase Book.

An Invoice is a statement sent by the seller to the buyer giving a full description of the goods supplied. An Invoice or Bill prepared by the supplier of the goods. Seller prepared an invoice normally in duplicate or triplicate.

From seller's point of view, this invoice is an Outward Invoice and from buyer's point of view, the same invoice is an Inward Invoice. Entries are recorded in the Purchase Book on the basis of Inward Invoice and entries are recorded in the Sales Book on the basis of Outward Invoice.

When the buyer receives such an invoice, he has to verify whether the goods are received as per the details given in the invoice in regard to quantity, quality rates etc. The buyer can verify the calculation and terms and conditions of the purchase. For the seller, invoice is a proof for goods sold while for the buyer invoice is a proof for goods purchased.

The amount of trade discount is deducted from the invoice itself. Therefore, a trade discount does not appear in the purchase book. Only the net value is recorded in the Purchase Book.

Ruling/Format/Proforma of Purchase Book

Date	**Name of Suppliers**	**L.F.**	**Inward Invoice No.**	**`**

Note:

1. The columns of the purchase book may differ according to necessity.
2. *L.F. column :* Purchase book is a book of original entry therefore as per regular practice the page number of ledger on which supplier's account appears is entered in this column.
3. *Details column:* Trade discount, unit, rate etc. are written in the column. Generally, the value of goods purchased (gross price) and amount of trade discount are written in this column.

Posting of the Purchase Book

As and when a transaction is entered in the Purchase Book on the same day, it is credited to the Personal Accounts of Suppliers with respective amount of Purchase as *'By Purchase'*. But no posting is immediately done in Purchase Account in ledger. At the end of the month or at a certain period, *"Purchase Account"* in the ledger is debited with the total amount of Purchase Book as *"To Sundries as per Purchase Book."* In other words, Supplier's A/c will be credited with the amount of purchase on the same day of transaction. The corresponding debit to Purchase A/c will not be done for individual transaction of purchase on same day, but the total purchase of entire month shall be posted to Purchase A/c at the end of the month or a certain period so specified.

Illustration 5

Recorded the following transactions in the purchase Book of Mr. Kartik and post them in the ledger.

2001

Jan.

1 Bought goods from Ramnik & Co. of ` 800.

2 Purchased one fan for office use from Srinath Traders of ` 1,200

8 Bhavesh & Co. invoiced goods to us of ` 1,000

10 Cash purchases of ` 300.

11 Rajesh sold goods to us (` 1,500 Less: 10% T.D.) of ` 1,350.

12 Purchase goods from Jayesh of ` 1,400 in exchange of furniture of the same amount.

13 Purchase goods from Yogesh & Co. of ` 600.

Solution

In the Books of Mr. Kartik

Date	Name of Suppliers	L.F.	Inward Invoice No.	`
2001 Jan				
1	Ramnik & Co.			800
8	Bhavesh & Co			1,000
11	Rajesh			1,350
13	Yogesh			600
	Total			**3,750**

Note:

1. No entry in P.B. for 2nd Jan, 2001. Entry for this transaction comes in J.P. as follows:

Fan A/c	Dr.	1200	
To Srinath Traders A/c			1200

2. No entry in P.B. for 10th Jan, 2001. Entry for this transaction comes in C.B. as follows:

Purchase A/c	Dr.	300	
To Cash A/c			300

3. No entry in P.B. for 12th Jan, 2001. Entry for this transaction comes in J.P. as follows:

Purchase A/c	Dr.	1400	
To Furniture A/c			1400

Dr. Ramnik & Co.'s A/c Cr.

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
				2001 Jan 1	By Purchases A/c		800

Dr. Bhavesh & Co.'s A/c Cr.

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
				2001 Jan 8	By Purchases A/c		1,000

Dr. Rajesh & Co.'s A/c Cr.

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
				2001 Jan 11	By Purchases A/c		1,350

Dr. **Yogesh & Co.'s A/c** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
				2001 Jan 13	By Purchase A/c		600

Dr. **Purchases A/c** **Cr.**

Date	Particulars	J.F.	₹	Date	Particulars	J.F.	₹
2001 Jan 13	To Sundries as per Purchase Book		3750				

2. Sales Book

This is the book of prime entry which records all transaction of credit sales of goods.

In this book, all the goods sold on credit are recorded. Sale of old machinery on credit or goods sold on cash basis etc. are not entered (recorded) in the Sales Book. As similar to Purchase Book, a separate Sales Book is maintained to record all credit sales of goods. A transaction to find place in Sales Book must comply with two conditions, *viz.*, (i) The transaction must be a credit transaction. (ii) It must involve sale of *"goods"* kept in business for resale purpose. Cash sales of goods are recorded in the Cash Book, while credit sale of assets are recorded in the Journal Proper.

A Sales Book is also known as Sales Journal, Sales Register, Sales Day Book, Sold Book etc.

Basis of Writing a Sales Book

Out ward invoice is the base for writing of sales book.

An Invoice is prepared when the goods are sold. Such an invoice is known as the outward invoice for seller of goods.

The original copy of an invoice is given to the buyer who purchases goods on credit and the carbon copy is kept by seller for reference.

Ruling/Format/Proforma of Sales Book

Date	Name of Customers or Particulars	L.F.	Outward Invoice No.	₹

Note: The columns of Sales Book may differ according to necessity.

Posting of the Sales Book

As and when a transaction is entered in the Sales Book, on the same day it is debited to the Personal Accounts of customers with respective amount of sale as 'To Sales'. But no posting is immediately done in the 'Sales A/c' in ledger. At the end of the month or at a certain period 'Sales A/c' in the ledger is credited with the total amount of Sales Book as 'To Sundries as per Sales Book', In other words, Customer's A/c will be debited with the amount of sales on the same day of transaction. The corresponding credit to Sales Account will not be done for individual transaction of sale on the same day, but the total sales of entire month shall be posted to Sales Account at end of the month or a certain period so specified.

Illustration 6

Record the following transactions in the Sales Book of Mr. Rajput and post them to ledger accounts.

1999

Sept.

		`
1	Sold goods to Rajesh Bros.	1,500
5	Goods sold to Prakash Stores on cash basis	1,000
8	Supplied Goods to Pooja & Co.	1,200
12	Sold old typewrite to ABC Co. Ltd.	2,000
15	Invoiced goods to Pratap & Co.	1,800
18	Machinery sold for cash to Girish	2,000
25	Manish purchased goods from us.	900

Solution

Sales Book of Mr. Rajput

Date	Name of Customers	J.F.	Outward No.	`
1999				
Sept 1	Rajesh & Co.		–	1,500
3	Pooja & Co.		–	1,800
15	Pratap & Co.		–	1,800
25	Manish		–	900
	Total			**5,400**

Notes:

1. No entry in S.B. for 5th Sept., 1999. Entry for this transaction comes in C.B. as follows.
2. No entry in S.B. for 12th Sept., 1999. Entry for this transaction comes in J.P. as follows.
3. No entry in S.B. for 18th Sept,, 1999. Entry for this transaction comes in C.B. as follows.

Dr. **Rajesh's A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
1999							
Sept. 1	To Sales A/c		1,500				

Dr. **Pooja & Co.'s A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
1999							
Sept. 3	To Sales A/c		1,200				

Dr. Pratap & Co.'s A/c Cr.

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
1999 Sept. 15	To Sales A/c		1,800				

Dr. Manish's A/c Cr.

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
1999 Sept. 15	To Sales A/c		900				

Dr. Sales A/c Cr.

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
				1999 Sept. 30	By Sundries as per Sales Book		5,400

Illustration 7

Prepare Purchase Book and Sales Book of Mr. Dilwala from the following transactions.

2001

July

1	Sold to Mr. Shashtri goods of ` 4,000.
5	Bought from Mr. Bhavanji goods of ` 3,000.
10	Purchased a fan on credit from Usha Fan Co. for ` 1,200.
12	Mr. Kasyap purchased from us goods worth of ` 6,000.
16	Mr. Mansukh sold goods to us of ` 4,000.
18	Placed an order with Ramesh for goods of ` 2,500.
21	Mr. Yogesh bought goods from us worth ` 5,000 less 10% T.D.
24	Ramesh executed our order and goods received along with the Invoice No. 402.
25	Sold goods to Mr. Shyam of ` 10,000 at 5% discount.
26	Sold goods to Mr. Kartik of ` 2,500 for which cheque is received.
30	Purchase goods from Raj ` 3,000.

Solution

In the Books of Mr. Dilwala

Dr. Purchase Book Cr.

Date	Name of Supplier	L.F.	Inward Inv. No.	`
2001				
July 5	Bhavanji		–	3,000
16	Munsukh		–	4,000
24	Ramesh		402	2,500
30	Raj		–	3,000
	Total			**12,500**

Dr. **Sales A/c** **Cr.**

Date	Name of Customer	L.F.	Outward Inv. No.	`
2001				
July 1	Shastri		–	4000
12	Kasyap		–	6000
21	Yogesh		–	4500
25	Shyam		–	5500
	Total			24,000

Note:

1. No entry in PB. for 10th July, 01. Entry for the this transaction comes in J.P. as follows:

Fan A/c	Dr.	1,200	
To Usha Fan A/c			1,200

2. No entry in books of A/c for 18th July, 01because it is not a transaction.
3. No entry is S.B. for 26th July, 01. Entry for this transaction comes in C.B. as follows:

Bank A/c	Dr.	2,500	
To Sales A/c			2,500

In the Books of Mr. Dilwala

Dr. **Bhavanji's A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
				2001			
				July 5	By Purchase A/c		3,000

Dr. **Purchase A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
2001							
July 31	To Sundry as per A/c		12,500				

Dr. **Yogesh's A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
2001							
July 21	To Sales A/c		4,000				

Dr. **Sales A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
				2001			
				July 31	By Sundries as per S.A.		2,400

Dr. **Shyam's A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
2001							
July 25	To Sales A/c		9,500				

Dr. **Raj's A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
				2001 July 30	By Purchase A/c		3,000

Dr. **Mansukh's A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
				2001 July 16	By Purchase A/c		4,000

Dr. **Ramesh's A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
				2001 July 24	By Purchase A/c		2500

Dr. **Shastri's A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
2001 July 1	To Sales A/c		4,000				

3. Purchase Return Book

This is the book of prime entry which records all returns of goods purchased on credit.

In this book, all the transactions of return of goods purchased on credit are recorded. A transaction of a return of assets will not comes in the Purchase Return Book.

A Purchase Return Book is also known as Purchase Return Journal or Return Outward Book.

The goods purchased may be returned for one or two of the following reasons:

1. If the goods supplied are not as per the sample/order.
2. If the goods are in excess of the requirements.
3. If the goods are damaged in transit.
4. If the supply of goods is delayed.
5. If the goods are of different designs and colour.
6. If the goods supplied are of inferior quantity.

Basis of Writing a Purchase Return Book

Debit Note is the base for recording a transaction in Purchase Return Book.

A debit note is a statement sent by buyer to the supplier (seller) stating the full details of the goods returned. A debit note is sent to the supplier at the time of return of goods or after the goods returned. Debit Note intimates (informs) the supplier (seller) that his account has been debited by the amount of goods returned to him.

Sometimes, goods are received correctly as per the Invoice but the Invoice is overcharged. Therefore, the Invoice shows a higher amount than what it should be in such a case, the debit note is sent without return of goods. On receiving the debit note, the supplier (seller) also sends a credit note to us.

Ruling/Format/Proforma of Purchase Return Book

Date	Name of Suppliers or Particulars	L.F.	Debit Note No.	`

Note: The columns of Purchase Return Book may differ according to necessity.

Posting of the Purchase Return Book

Debit the personal account of the suppliers with the respective amount of the purchase return as 'To Purchase Return A/c'.

At the end of the month credit, the Purchase Return A/c in the ledger with the total of the purchase return book as 'By Sundries as per Purchase Return Book'.

Illustration 8

Record the following transactions in Purchase Return Book of Jalpa & Co. and post them to ledger.

2002

Feb.

1. Returned goods to Reema & Co. of ` 700.
4. M/s Keshav Stores received goods returned by us ` 500.
10. Machine costing ` 4,000 Returned to M/s Seema Engineering Work because it is not working well.
18. Returned goods to Kanta Stores as they were defective of ` 200.
25. Sent debit note to Reshma & Co. of ` 400 for goods returned.
28. Returned goods to Janata Stores of ` 300 as it was defective and received cash for it.

Solution

In the Books of Jalpa & Co.

Date	Name of Supplier	L.F.	Dr. Note No.	`
2002				
Feb. 1	Reema & Com.		–	700
4	Keshav Stores		–	500
15	Kanta Stares		–	200
25	Reshma & Co.		–	400
	Total			**1,800**

Note:

1. No entry in PRB – for 10th Feb. 2002. Entry for this transaction comes in J.P.

Seema Engg. Workers' A/c	Dr.	4,000	
To Machinery A/c			4,000

2. No entry in PRB for 28th Feb. 2002. Entry for this transactions in C.B. is as follows:

Cash A/c	Dr.	300	
To P/R A/c			300

Dr. **Reema & Co.'s A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
2002 Feb 1	To P/R A/c		500				

Dr. **Keshav Stores A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
2002 Feb 4	To P/R A/c		500				

Dr. **Kanta's A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
2002 Feb 18	To P/R A/c		200				

Dr. **Reshma & Co A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
2002 Feb 25	To P/R A/c		400				

Dr. **P/R A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
				2002 Feb 22	By Sundry as per Sales A/c		1,800

4. Sales Return Book

This is the book of prime entry which records all returns of goods sold on credit.

In this book, all the transactions of returns of goods sold on credit are recorded. A transaction of return of assets will not come in the Sales Return Book.

Sales Return means goods sold by a supplier are returned by a customer.

A Sales Return Book is also known as Sales Return Journal or Return Inward Book.

Goods sold to customers may be returned by them if the goods supplied to them are not up to the sample or of inferior quality or damaged etc.

Basis of Writing a Sales Return Book

Credit Note is the base for recording the transaction in Sales Return Book.

A Credit Note is a statement sent by supplier (seller) to the buyer stating the full details of goods returned by buyer. A Credit Note is sent to the buyer (customer) when supplier (seller) received goods returned by the buyer. Credit note intimates (informs) the buyer (customer) that his account has been credited by the amount of goods returned by him.

Credit Note is also sent for correcting the mistake like overcharging in the invoice. Credit note gives the details of goods returned by a buyer (customer) or overcharging of Invoice. From the credit note, buyer's (customer's) Account will be credited.

Ruling/Format/Proforma of Sales Return Book

Date	Name of Customers or Particulars	L.F.	Debit Note No.	`

Note: The columns of the Sales Return Book may differ according to necessity.

Posting of the Sales Return Book

At the end of the month debit the Sales Return A/c in the ledger with the total of the Sales Return Book as 'To Sundries as per Sales Return Book'.

Credit the personal account of the customers with the respective amount of the Sales Return as 'By Sales Return A/c'.

Illustration 9

Record the following transactions in the Sales Return Book and post them to ledger.

2014

March

1 Bajirao returned goods to us of ` 200.

5 Goods returned to us by Kamraj of ` 300 and paid cash for it.

12 Mayank returned goods of ` 250.

16 Goods sold to Rajesh is defective therefore returned from Rajesh goods of ` 400.

25 Sent credit note to Rajeev of ` 450 for goods returned by him.

30 Received debit note from Adesh of ` 500 for goods returned by him.

Solution

Date	Name of Customer	L.F.	Cr. Note No.	Amount
2002				
March 1	Bajirao		–	200
12	Mayank		–	250
16	Rajesh		–	400
25	Rajeev		–	450
30	Adesh		–	500
	Total			**1,800**

Note:

1. No entry in SRB 5th March, 2000. Entry for this transaction comes in as follows:

S/R A/c	Dr.	300	
To Cash A/c			300

Dr. **Bajirao's A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
				2002 March 1	By S/R A/c		200

Dr. **Mayank's A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
				2002 March 12	By S/R A/c		250

Dr. **Rajesh's A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
				2002 March 16	By S/R A/c		400

Dr. **Rajeev's A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
				2002 March 25	By S/R A/c		450

Dr. **Adesh's A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
				2002 March 30	By S/R A/c		500

Dr. **S/R A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F	`
2002 March 31	To Sundries per S/R Book		1800				

Illustration 10

Following is the transaction in the books of A. Say in which subsidiary book (goods journal) entry comes.

(a) Goods sold to Mr. Z

Ans: Sales Book.

(b) Goods returned to Manish.

Ans: Purchase Return Book.

(c) Goods purchased by Rakesh.

Ans: Sales Book.

(d) Goods returned by Balu which is unacceptable.

Ans: No entry.

(e) Goods purchased from Mr. P.

Ans: Purchase Book.

(f) Furniture sold on credit to Imandar.

Ans: No Entry.

(g) Goods returned by Ram of ` 1,500.

Ans: Sales Return Book.

(h) Above goods sold to Mr. Raghunath at the loss of ` 200/- in the Invoice price.

Ans: Sales Book (Amt. ` 1,300)

(i) Goods returned by Mr. Bhola.

Ans: Sales Return Book.

(j) Goods worth ` 800/- returned to Mr. Sherkhan as it was defective. In exchange, a fresh lot of goods received of the same value. Neither Debit Note prepared nor bill is issued for it.

Ans: No entry.

(k) (i) Goods purchased from Badal worth of ` 3,000/-.

(**Ans:** Purchase Book.

(ii) Above goods sold to Mr. Sky at ` 4,000.

Ans: Sales Book.

(iii) Mr. Sky returned half of the goods sold to him, the same goods returned to Badal.

Ans: Sales Returned Book (Amt. ` 2,000)

Purchase Returned Book (Amt. ` 1,500)

(l) Mr. A, proprietor withdrawn goods for his personal use.

Ans: No entry.

(m) Purchased goods worth ` 5,000 from Miss Bijali. Half the amount paid in cash.

Ans: Purchase Book. (Amt. ` 2,500)

(n) A Debit Note issued to Mr. K.

Ans: Purchase Return Book

(o) A Credit Note issued to Mr. M.

Ans: Sales Return Book.

(p) Goods sold by Rohan to us.

Ans: Purchase Book.

(q) Purchased stationery from Kamal.

Ans: No entry.

(r) Goods sold to Sohan for cash.

Ans: No entry.

(s) Goods costing ` 800 received from Tata Co. Ltd. as free sample, it is the type of goods latest introduced by them.

Ans: No entry.

(t) Goods purchased from Rahul for which cheque paid.

Ans: No entry.

(u) Mr. A, proprietor withdrawn goods for his personal use worth ` 2,000 for which invoice is prepared on his name.

Ans: Sales Book.

(v) A debit note received from Mr. D.

Ans: Sales Return Book.

(w) A Credit Note received from Mr. L.

Ans: Purchase Return Book

Problems for Self Assessment

1. From the particulars given below, prepare proper Subsidiary books of Shri Mulchand.

2014

May

1 Bought goods from Rasik ` 2,000 less 10% T.D. and 5% C.D. terms.

4 Sold goods to Laherchand of ` 1,000 less 10% T.D. and 2% C.D. terms.

5 Purchased goods from Laherchand of ` 1,500 at 5% T.D.

8 Vimal bought goods from us ` 800.

10 Returned goods to Laherchand ` 200 (gross).

12 Cash sale of ` 500.

14 Rasik received goods returned by us ` 500.

15 Sold machinery for ` 5,000.

16 Bought goods worth ` 8,000 Less 5% T.D. and 2% C.D. from Bhushan Stores.

18 Invoiced goods worth ` 1,000 on 4% T. D. and 1% C.D. to Heena Ltd.

19 Returned goods to Bhushan Stores worth ` 1,000 (gross value) as they were defective.

22 Returned goods to us of ` 100 (Gross value) by Heena Ltd. as they were not as per sample.

24 Received an order for the supply of good ` 6,000 from Bharat & Co.

25 Placed a purchase order with Ratan & Sons for the supply of goods ` 8,000.

28 Dispatched goods to Bharat & Co. as per order received on 24th May, 2014.

2. Record the following transactions in Sales Book, Purchase Book and Return Book of Shri Tarachand for April 2014.

1 Purchased goods of ` 7,000 from Sajeed as per his Invoice No. 0425.

3 Sold goods to Amit Traders for ` 3,500 as per Invoice No. 202.

5 Sold goods to Sangam Bazar for ` 2,000 as per Invoice No. 203.

6 Purchased goods worth ` 5,000 from Arihant & Co. as per their Invoice No. A-4052.

7 Sangam Bazar returned goods worth ` 500 for which they were given Credit Note No. A-11.

10 Returned goods worth ` 500 to Sajeed and issued Debit Note No. D-8.

12 Sold goods to Anmol Stores for ` 500 on 5% T.D. terms as per Invoice No. 204.

14 Anmol Stores returned goods worth ` 100 (gross) being defective. Credit Note No. A-12 issued to them.

17 Purchased furniture worth ` 750 for office from Star Furniture Mart as per their Invoice No. 508.

18 Sold goods to Narayan General Stores for ` 1,000 as per Invoice No. 205 and purchased from them goods worth ` 200 as per their Invoice No. 99.

25 Sold goods worth ` 400 to Dev & Co. as per Invoice No. 206.

27 Sold old typewriter to Ashok Bros. for ` 1,000.

30 Purchased goods worth ` 3,000 from Patil Stores and asked them to deliver these goods to Akshay Stores. Patil Stores sent their Invoice No. 4252 to us and our sales Invoice No 207 for ` 3,500 was sent to Akshay Stores.

3. From the following instructions, prepare Subsidiary books of goods for Nikunj Traders.

2014

July

1 Purchased from Patkar & Co. goods at lumpsum price of ` 2,255, Invoice No. XY42529.

4 Sold old machinery for ` 3,000 to Kartik works.

7 Returned goods by Pankaj Stores of ` 800 (gross) T.D. was allowed at 10% a debit Note No.108 is received from him while our Credit Note No. AB708 is given for the same amount. The goods was supplied in excess than ordered.

8 Goods sold to Mr. Manek worth ` 10,000 at 15% T.D. and 2% C.D., a cheque received from him.

10 Returned goods worth ` 600 to Patkar & Co. Debit Note No. L304 sent while Credit Note received from him No.CD/202 for the same amount.

12 Goods sold by Keshavchandra & Co. to us of ` 10,000 at 10% T.D.

14 Sent our Invoice to Mayank Traders for goods supplied (Quantity 4 dozens of 0.45 size) of ` 8,000 (net) after deducting T.D. 20%

16 Sagar & Co. supplied goods to us of Catalogue price of ` 6,000 at 10% T.D. and 10% C.D. if the payment will be made within one week.

18 Dispatched goods worth ` 5,000 to Mangal Stores as per their order which is pending since last month.

20 Received an order from M/s Kanji Stores for goods worth ` 3,000.

Trade Discount

It is a reduction granted by a supplier from the list price of goods or services on business consideration (such as quantity bought, trade practices etc.). For prompt payment, cash discount is allowed.

Example: If 5 gold coins are sold at the list price of ` 15,000 each subject to trade discount of 12%, the trade discount will be calculated as under:

5 Gold coins @ ` 15,000	75,000
Less: Trade discount @ 12%	9,000
Amount payable as per invoice	**66,000**

Cash Discount

It is the reduction granted by the supplier from the invoice price in consideration of immediate payment or payment within a stipulated period.

Example: If 5 gold coins are sold at the list price of ` 15,000 each subject to trade discount of 12%, the invoice price after trade discount is ` 66,000. Cash discount terms are 2%, 30 days. This denotes the buyer will get 2% cash discount if he makes payment within 30 days. The cash discount is calculated as follows:

Amount payable as per invoice	66,000
Less: Cash discount @ 2%	1,320
Cash payable within 30 days	**64,680**

Difference between Trade Discount and Cash Discount

1. Trade discount is a reduction granted by a supplier from the list price on goods or services on business considerations such as quantity bought, trade practices etc., while cash discount is a reduction granted from the invoice price in consideration of immediate payment or payment within a stipulated period.
2. Trade discount is allowed to promote the sales while cash discount is allowed to encourage early or prompt payment.
3. Trade discount is shown by the way of deduction in the invoice itself. Hence, no further entry is required in the books of accounts. Cash discount is shown as an expense in profit and loss account.
4. Trade discount may vary with the quantity purchased while cash discount varies with the period.

Illustration 11

From the following transactions, prepare the purchase book of Adithya Bros and post the transactions recorded in the Purchase book to the Ledger:

Date	Invoice No.	Particulars
5.3.2014	442	Purchased on credit from Goyal Bros – 55 Polyester sarees @ ` 100 *Less:* Trade Discount @ 10%
8.3.2014	445	Purchased for cash from Greg Mac – 100 Orissa cotton sarees @ ` 200
15.3.2014	450	Purchased on credit from Adikari Mills – 10 Silk sarees @ 10%

Solution

Purchase Book

Date	Purchase Invoice No.	Name of the supplier	L.F.	Details	`
5.3.2014	442	Goyal Bros		5,500	
		Less: Trade Discount @ 10%		500	4,950
8.3.2014	450	Adikari Mills		25,000	
		Less: Trade Discount @ 10%		2,500	22,500

Cash purchases from Greg Mac will be recorded in cash book.

Ledger of Adithya Bros

Dr. **Goyal Bros A/c** **Cr.**

Date	Particulars	L.F.	`	Date	Particulars	L.F.	`
				5.3.2014	By Purchases A/c		4,950

Dr. **Adikari Mills A/c** **Cr.**

Date	Particulars	L.F.	`	Date	Particulars	L.F.	`
				8.3.2014	By Purchases A/c		22,500

Dr. **Purchases A/c** **Cr.**

Date	Particulars	L.F.	`	Date	Particulars	L.F.	`
31.3.2014	To Sundries as per Purchase Book		27,450				

Observe that in every case of credit purchase, the supplier's account is credited and goods account is debited.

At the end of the day or week or month, the total of purchases is transferred to one ledger account known as Purchases account in the ledger.

Illustration 12

From the following transactions, prepare the Sales Book of Adithya Bros and post the transactions recorded in the Sales book to the Ledger:

Date	Invoice No.	Particulars
5.3.2014	442	Sold on credit from Goyal Bros – Polyester sarees @ ` 100 *Less:* Trade Discount @ 10%.
8.3.2014	450	Sold on credit from Adikari Mills – 10 silk sarees @ ` 2,500 *Less:* Trade Discount @ 10%.

Solution

Sales Book

Date	Sales Invoice No.	Name of the supplier	L.F.	Details	`
5.3.2014	442	Goyal Bros *Less:* Trade Discount @ 10%		5,500 500	 4,950
8.3.2014	450	Adikari Mills *Less:* Trade Discount @ 10%		25,000 2,500	 22,500

Cash Sales from Greg Mac will be recorded in cash book.

Ledger of Adithya Bros

Dr. **Goyal Bros A/c** **Cr.**

Date	Particulars	L.F.	`	Date	Particulars	L.F.	`
5.3.2014	To Sales a/c		4,950				

Dr. **Adikari Mills A/c** **Cr.**

Date	Particulars	L.F.	`	Date	Particulars	L.F.	`
5.3.2014	To Sales a/c		22,500				

Dr. **Sales A/c** **Cr.**

Date	Particulars	L.F.	`	Date	Particulars	L.F.	`
				5.3.2014	By Sundries as per Sales Book		27,450

Example:

In the Books of Sham Sunder & Co.
Bills Receivable

No. of the Bill	Date of Receipt	From Whom Received	Acceptor	Where Payable	Term of the Bill	Due Date	L.F.	`	Rem-arks
1	04.7.14	04.70.4	Mr. X	Delhi	3 mths	7.10.14		7,000	
2	1.8.14	01.8.04	Mr. Y	Noida	4 mths	4.12,14		9,000	
3	9.9.14	09.9.04	Mr. A	Agra	3 mths	12,12.14		12,000	
4	10.9.14	10.9.04	Mr. B	Delhi	4 mths	13.1.14		10,000	
								38,000	

For every bill, the due date is calculated after adding three days of grace. The total of the bill receivable is transferred to bills receivable account in the ledger. The bills receivable account shows debit balance and the amount receivable against them is an asset.

Example:

Book of Sun Shine Co.
Bills Payable

No. of the Bill	Date of Receipt	To Whom Given	Drawer	Payee	Where Payable	Due Date	L. F.	`	Date of Pay-ment	Rem-arks
1	7.6.2014	Ram & Co.	Ram & Co.	Agra	3 mths	10.9.2014		56,000		
2	12.6.2014	Sunder	Sunder	Delhi	4 mths	15.10.2014		72,000		
3	20.6.2014	KV. & Co.	KV. & Co.	Chennai	5 mths	23.11.2014		50,000		
								1,78,000		

CASH BOOK

MEANING

A subsidiary book or book of original entry in which cash transactions as well as banking transactions are recorded is known as cash book. Thus, cash book is a subsidiary book or a book of original entry meant for the recording of all receipts and payments of cash. All cash transactions are recorded in the cash book. Credit transactions are not recorded in cash book.

Cash book is a book of original entry in which only cash receipts and cash payments are recorded. It is divided into two sides, 'Receipt side' and 'Payment side'. When cash, cheque or draft is received, the details are recorded on the left hand side which is known as Receipt side or Debit Side. When cash, cheque or draft is issued, the details are recorded on the right hand side which is known as Payment side or Credit side. Cash book is a chronological record of all cash transactions. The cash book serves the purpose of book of original entry and also represents cash account in ledger. In fact, it is more of a ledger than a journal. It is a journal since cash transactions are recorded in chronological manner. It is a ledger since it constitutes a classified record of all cash transactions in the form of ledger with narrations and helps in finding out cash balance at the end of a particular accounting period. Thus, it can be said that cash book serves dual purpose of journal as well as ledger. Hence, the cash book is considered as a combination of Journal and Ledger.

Utility of Cash Book

From the following points, we can see and understand the utility of Cash Book.

1. **Avoid Duplication of Work:** When Cash Book is maintained, there is no need to draft journal entries for cash transactions and operate Cash A/c in the ledger. This avoids duplication of work.
2. **Dual Role:** The Cash Book plays dual (double) role as a Journal (subsidiary book) as well as a Ledger.
3. **To Ascertain the Cash Balance:** Businessman gets information of inflow and outflow of cash from Cash Book.
4. **Useful to All:** Cash Book is useful to all types of business organization.
5. **Saves Labour, Time and Money:** Both, Cash transaction and Banking transactions are recorded in Cash Book. Journal and Ledger Accounts are not required for both the transactions. Thus, Cash Book Saves labour, time and money.
6. **Cross-checking and Verification of Correctness:** Cross-checking and verification of correctness of cash and banking transactions are possible due to Cash Book.

Features of Cash Book

1. Cash Book is just similar to Cash A/c.
2. Receipt of cash are always recorded on the left hand side, *i.e.*, debit side of cash book and payment of cash are recorded on the right hand side, *i.e.*, credit side of Cash Book.
3. Cash transactions and banking transactions are recorded in Cash Book.
4. Totaling and balancing of cash book can be done daily, weekly, fortnightly or monthly to find out (to know) cash and bank balance.
5. A Cash Book has two sides left hand side is known as Receipt side and right hand side is known as Payment side.

Types of Cash Book (Detail)

1. Single Column Cash Book/Simple Cash book
2. Double Column Cash Book
   (a) Cash and Discount columns
   (b) Cash and Bank columns
   (c) Bank and Discount columns
3. Triple column cash book having Cash, Bank and Discount columns
4. Petty Cash Book

OR

Types of Cash Book (as per Government Textbook)

Cash Book can be maintained in different ways depending on the need and nature of business concerns. Following are the different types of cash book:

1. Single Column Cash Book/Simple Cash Book (Cash column only)
2. Double (Two) Column Cash Book (Cash Book with cash and bank columns)
3. Petty Cash Book

SIMPLE CASH BOOK

Meaning

Simple cash book has one amount column on each of receipt side and payment side. It records only cash receipts and payments. This cash book is suitable for traders operating on a very small scale. The cash book is prepared to keep record of all cash transactions and find the cash balance at the end of a particular accounting period.

Source documents for writing Simple cash book are as under:

1. Cash receipts received
2. Cash receipts issued
3. Cash memos received
4. Cash memos issued
5. Vouchers

Format/Proforma of Simple Cash Book:

In the Books of ……………

Simple Cash Book

Dr. (Receipts)					(Payments) Cr.				
Date	**Particulars**	**R. No.**	**L.F.**	**`**	**Date**	**Particulars**	**V. No.**	**L.F.**	**`**
	To					By			

Columns in Simple Cash Book

The Simple Cash Book is vertically divided into two sides where the left hand side is receipt side and the right hand side is payment side.

Receipt Side

1. **Date column:** The date of transaction is written in this column.
2. **Receipt number column:** The serial number of receipts and cash memos supporting the entry is recorded in this column.
3. **Particulars:** The account which is affected along with a brief narration is recorded in this column. It always begins with the word "To".
4. **Ledger folio:** It contains the page number of the ledger where the transaction has been posted.
5. **Amount column:** The amount received is recorded in this column.

Payment Side

1. **Date:** The date of the transaction is recorded in this column.
2. **Voucher number:** The serial number of voucher and cash memos supporting the entry is recorded in this column.
3. **Particulars:** The account which is affected along with a brief narration is recorded in this column. It always begins with the word "By".
4. **Ledger folio:** It contains the page number of the ledger where the transaction has been posted.
5. **Amount column:** The amount paid is recorded in this column.

Recording in Simple Cash Book

The procedure for recording in the simple cash book is explained below:

Previous month's balance or opening balance, if any, appears on the receipt side as "To Balance b/d" (b/d means brought down). In case of new business, capital contributed by proprietor appears on receipt side as "To Capital A/c". When cash is received on any account the name of account is entered in particulars column on the receipt side. When cash is paid on any account, the name of account is entered in particulars column on the payment side. Transactions are to be recorded in the order of date only.

This cash book is suitable for traders operating on a small scale.

Balancing of Simple Cash Book:

After recording transactions of a particular period, simple cash book is balanced to find out balance of cash in hand. This is done by recording the excess of receipts on the payment side or excess of debit on the credit side as "By Balance c/d" (c/d means carried down) to make the two sides equal. This balance is then entered on the receipt side as "To Balance b/d" to start the next period. Since, one cannot pay more than what one has actually received, the cash book recording only cash transactions (Simple Cash Book) will always have excess of receipts over payments.

The cash book is a book of original entry where all cash and bank transactions relating to receipts and payments are recorded. It serves the purpose of journal as well as ledger.

Since the cash book enables the trader to find out the daily cash and bank balance, there is no need to open separate Cash A/c and Bank A/c.

Different Types of Cash Book:

(i) Simple Cash Book is single column cash book with one cash column on each side.

(ii) Double Column Cash Book, *viz*., Cash and Discount column on each side.

(iii) Triple Column Cash Book, *viz*., Cash, Discount and Bank column on each side.

Example:

Single Column Cash Book of Rekha & Bros

Date	Receipts	Cash	Date	Payments	Cash
2014			2014		
July 1	To Balance b/d	4,500	July 1	By Rent of Shop A/c	900
4	To Sales A/c	8,050	3	By Postage A/c	50
10	To Interest on FD A/c	2,000	14	By Purchases A/c	7,000
20	To Commission A/c	4,000	20	By Stationery A/c	800
28	To Sale of Goods A/c	10,000	28	By Wages A/c	2,000
30	To Balagopalan's A/c	5,000	31	By Narasimhan's A/c	9,000
				By Balance c/d	13,800
	Total	**33,550**		**Total**	**33,550**

Example:

Two Column Cash Book of Simpson Co.

Date	Receipts	Cash	Bank `	Date	Payments	Cash	Bank `
2014				2014			
Apr 5	To Balance b/d	1,500	13,000	Apr 2	By Wages A/c		400
7	To Sales A/c	800		5	By Electricity A/c	50	
11	To Ashok Co.'s A/c		2,000	8	By Repairs A/c	400	
20	To Beta Co.'s A/c		2,350	15	By Venki Ltd.'s A/c		10,800
	To Sales A/c	500		30	By Balance b/d	2,350	6,150
	Total	**2,800**	**17,350**		**Total**	**2,800**	**17,350**

Example:

Three Column Cash Book of Janardhan Works

Date	Receipts	Disco-unt	Cash	Bank	Date	Payments	Disco-unt	Cash	Bank
2014					2014				
Jan 2	To Balance b/d		3,700	4,500	Jan 6	By Wages A/c		1,550	
5	To Patel's A/c	100	2,400		3	By Agarwal's A/c	50	950	
10	To Neelima's A/c			6,000	15	By Cash A/c (C)			3,000
15	To Bank A/c (C)		3,000		22	By Drawings A/c			2,000
30	To Cash A/c (C)			1,000	30	By Bank A/c (C)		1,000	
31	To Dividend from X Co.'s A/c			2,000	31	By Rent A/c			1,500
					31	By Balance c/d		5,600	7,000
	Total	**100**	**9,100**	**13,500**			**50**	**9,100**	**13,500**

Note the following points from the above illustration:

(a) Discount column on the debit side represents discount allowed and on the credit side, it represents discount received. Balancing is not done for these columns for a simple reason to find out separately the discount allowed and discount received.

(b) There are two contra entries each on 15th and 30th. On 15th, the transaction is cash withdrawn from bank ` 3,000. It is a payment from bank and it is receipt to business cash. Similarly, on 30th, cash is deposited to bank ` 1,000. It is a receipt to the bank account and payment from cash account.

(c) To indicate contra entry, “C” is mentioned against the entry.

(d) Drawings represent the amount withdrawn from bank for business purposes.

(e) Dividend from X Co. is received by cheque and the company should have remitted the dividend directly to the bank account of the businessman.

(f) The balance c/d is the closing balance for the month of January 2002 and this becomes opening balance for February 2002.

Illustration 13

Enter the following transactions in the single column cash book of Gopichand.

March, 2014		`
1st	Commenced business with cash	20.000
2nd	Bought goods for cash	5.000
3rd	Sold goods for cash	4.000
4th	Goods purchased from Ravi Kumar	10.000
10th	Paid to Ravi Kumar	7.000
14th	Cash sales	8.000
18th	Purchased furniture for office	4.000
22nd	Paid wages	500
25th	Paid rent	600
30th	Received commission	4.000
30th	Withdrew for personal purpose	1.000
31st	Paid salary	900

Solution

Cash Book of Gopichand

Date	Particulars	`	Date	Particulars	`
2014			2014		
March 1st	To Capital A/c	20,000	March 2nd	By Goods A/c	5,000
3rd	To Sales A/c	4,000	10th	By Ravi Kumar’s A/c	7,000
14th	To Sales A/c	8,000	18th	By Office Furniture A/c	4,000
	To Commission A/c	4,000	22nd	By Wages A/c	500
			25th	By Rent A/c	600
			30th	By Drawings A/c	1,000
			31st	By Salary A/c	900
			31st	By Balance c/d	17,000
		36,000			**36,000**

Hint: Goods purchased from Ravi Kumar is a credit purchase.

Illustration 14

Record the following transactions in two column cash book (Cash and Bank) in the books of Soft Silk Co. for the month of July, 2014. Find out the closing balances for the month of July 2004.

July, 2014		`
01st	Opening balance b/d (Cash)	14,500
	Opening balance b/d (Bank)	7,000
04th	Cash purchases	6,700
05th	Rent for June month paid by cheque	2,500
09th	Cash sales	15,200
12th	Dividend paid by cheque	4,350
15th	Cash deposited into bank	5,000
18th	Cash paid to Rahim & Bros to settle his account	10,000
20th	Repairs paid	1,000
22nd	Commission paid by cheque	2,000
23rd	Customer, Deepak remitted to our bank account	20,000
25th	Cash withdrawn from bank for office use	5,000
27th	Drawings made from business cash for personal purpose	2,000
28th	Purchased stationery by cash	3,000
30th	Cash withdrawn for personal use from bank	1,400

Solution

Two Column Cash Book

Date	Particulars	Cash	Bank	Date	Particulars	Cash	Bank
July 14				July 14			
1st	To Opening Balance b/d	14,500	7,000	4th	By Purchases A/c	6700	
9th	To Sales A/c	15,200		5th	By Rent A/c		2,500
15th	To Cash A/c (C)		5,000	12th	By Dividend Paid A/c		4,350
23rd	To Deepak A/c		20,000	15th	By Bank A/c (C)	5,000	
25th	To Bank A/c (C)	5,000		18th	By Rahim & Bros A/c	10,000	
				20th	By Repairs A/c	1,000	
				22nd	By Comm. Paid A/c		2,000
				25th	By Cash A/c (C)		5,000
				27th	By Drawings A/c	2,000	
				28th	By Stationery A/c	3,000	
				30th	By Drawings A/c		1,400
				30th	By Balance c/d	7,000	16,750
		34,700	**32,000**			**34,700**	**32,000**
	To Balance b/d	7,000	16,750				

Illustration 15

Enter the following transactions in the cash book with discount, cash and bank columns. Prepare three columnar cash book for the month of May.

May 1st Balance of cash in hand ` 14,000; bank overdraft at bank ` 5,000
4th Invested further capital ` 10,000 out of which ` 6,000 was deposited in the bank
6th Sold goods for cash ` 30,000
6th Collected from debtors of last year ` 80,000; Discount allowed to them ` 2,000
10th Purchased goods for cash ` 55,000
11th Paid Ram Vilas, our creditor ` 25,000; discount allowed by him ` 650
13th Commission paid to our agent ` 5,300
14th Office furniture purchased for cash ` 2,000
14th Rent paid ` 400; electricity charges paid ` 1,000
14th Drew cheque for personal use ` 7,000
17th Cash sales ` 25,000
18th Collection from Atal Bihari ` 40,000, deposited in the bank on 19th April
19th Drew from the bank for office use ` 5,000
22nd Drew cheque for petty expenses ` 1,500
24th Dividend received by cheque ` 500, deposited in the bank on the same day
25th Commission received by cheque ` 2,300, deposited in the bank on 28th April
29th Drew from the bank for salary of the office staff ` 15,000
30th Deposited cash in the bank ` 10,000.

Solution

Three Column Cash Book

Particulars	Disc `	Cash `	Bank `	Particulars	Disc `	Cash `	Bank `
To Balance b/d		14,000		By Balance b/d			5,000
To Capital		4,000	6,000	By Purchases		55,000	
To Sales		30,000		By Ram Vilas	650	25,000	
To Debtors	2,000	80,000		By Commission		53,000	
To Sales		25,000		By Office furniture		2,000	
To Atal Bihari		40,000		By Rent		400	
To Cash (C)			40,000	By Electricity		1,000	
To Bank (C)		5,000		By Drawings			7,000
To Dividend			500	By Bank (C)		40,000	
To Comm		2,300		By Cash (C)			5,000
To Cash (C)			2300	By Petty expenses			1,500
To Cash (C)			10,000	By Bank (C)		2,300	
				By Salary			15,000
				By Bank (C)		10,000	
				By Balance c/d		59,300	25,300
Total	**2,000**	**2,00,300**	**58,800**	**Total**	**650**	**2,00,300**	**58,800**

PETTY CASH BOOK

Petty cash book is a separate cash book where we record small or petty cash expenses of routine nature. It is of two types:

(i) Simple Petty Cash Book

(ii) Analytical or Columnar Petty Cash Book

In large organizations, petty expenses like stationery, postage, stamps, refreshments, carriage, cartage, daily wages etc. are incurred day in and day out. All these expenses are more in number and very insignificant in value. To look after payment of such expenses, a separate petty cashier is appointed who obtains a definite sum of money at the beginning of a month and gives a statement of account at the end of the period to the chief cashier. To record such payments, a separate book, known as petty cash book is maintained.

There is a distinct method, namely Imprest system which is adopted in maintaining such petty cash book. Under this system, at the beginning of a month, a definite sum of money is given by chief cashier to petty cashier for petty expenses. At the commencement of the next period, the petty cashier is reimbursed equal to what he had spent during the earlier period.

Illustration 16

Enter the following transactions in an analytical petty cash book. Also open relevant ledger accounts.

2014 Nov		`
1st	Received a cheque for petty cash	1,000
2nd	Paid bus fare to messengers	50
4th	Paid auto fare	70
10th	Postal stamps purchased	80
12th	Paid for stationery	90
15th	Paid for carriage	60
16th	Purchased envelopes	50
20th	Wages paid	100
25th	Tips given to driver	50
30th	Telephone calls paid	20

Solution

Petty Cash Book

Date	Particulars	Amount	Date	Particulars	V. No.	Total Payments	Analysis of Payments						L. F.	Ledger A/cs
							Tra `	Post `	Ca-rr `	P&S `	Wa-ges `	Sun-day		
Nov 1st	To Bank	100	Nov											
			1st	By Bus fare		50	50							
			2	By Auto fare		70	70							
			4	By Postal		80		80						
			10	By Stationery		90				90				
			12	By Carriage		60			60					

			15	By Envelopes		50				50				
			16	By Wages		100					100			
			20	By Tips		50						50		
			25	By Telegram		20		20						
			30	Total exp.		570	120	100	60	140	100	50		
			Nov. 30	By Balance c/d		430								
				Total		1000								
Dec 1st	To Bal b/d To Cash	430 570												

Cash Book

Date	Receipts	`	Date	Payments	`
			1st Nov	By Petty Cash	1,000
					1,000

Ledger

Dr. **Travelling Expenses A/c** **Cr.**

Date	Receipts	`	Date	Payments	`
1st Nov	To Petty Cash	120			

Dr. **Postage Expenses A/c** **Cr.**

Date	Receipts	`	Date	Payments	`
1st Nov	To Petty Cash	100			

Dr. **Carriage Expenses A/c** **Cr.**

Date	Receipts	`	Date	Payments	`
1st Nov	To Petty Cash	60			

Dr. **Printing and Stationery A/c** **Cr.**

Date	Receipts	`	Date	Payments	`
1st Nov	To Petty Cash	140			

Dr. **Wages A/c** **Cr.**

Date	Receipts	`	Date	Payments	`
1st Nov	To Petty Cash	100			

Dr. **Sundry Expenses Account** **Cr.**

Date	Receipts	`	Date	Payments	`
1st Nov	To Petty Cash	50			

Illustration 17

Prepare petty cash book on imprest system from the following particulars:

			`
(i)	Jan 1st	Received for petty cash payment	500/-
(ii)	Jan 2nd	Paid for postage	40/-
(iii)	Jan 5th	Paid for stationery	25/-
(iv)	Jan 8th	Paid for advertisement	150/-
(v)	Jan 12th	Paid for wages	50/-
(vi)	Jan 16th	Paid for carriage	25/-
(vii)	Jan 20th	Paid for conveyance	22/-
(viii)	Jan 25th	Paid for travelling expenses	80/-
(ix)	Jan 27th	Paid for postage	50/-
(x)	Jan 28th	Paid wages to cleaner	10/-
(xi)	Jan 30th	Paid for telegram	20/-
(xii)	Jan 30th	Sent registered notice	10/-

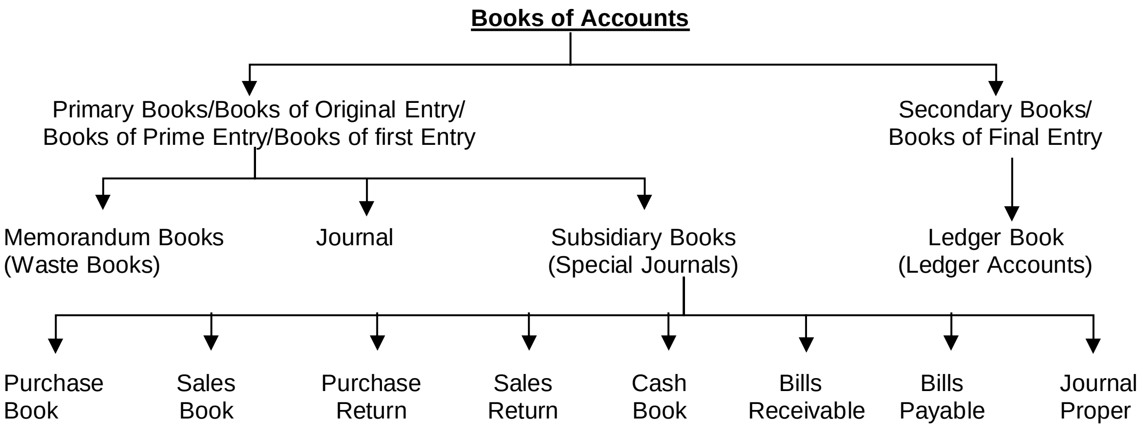
Solution

Petty Cash Book

Cash Recd `	**Date**	**Particulars**	**L.F.**	**Total Payment**	**P&T**	**Carriage**	**P&S**	**Advt.**	**Travel Exp.**	**Wages**	**Sundry**
500	2014 Jan 1st	To Cash									
	2nd	By Postage		40	40						
	5th	By Stationery		25			25				
	8th	By Advt		150				150			
	12th	By Wages		50						50	
	16th	By Carriage		25		25					
	20th	By Conveyance		22					22		
	25th	By Travelling		80					80		
	27th	By Postage		50	50						
	28th	By Wages		10						10	
	30th	By Telegram		20	20						
	30th	By Register		10	10						
500		Total		482	120	25	25	150	102	60	
18	July 1st	By Balance b/d		18							
482		To Cash A/c		500							

Books of Accounts

Generally, the following books of Accounts are maintained by a businessman for recording the business transactions.



Memorandum Book (Waste Book)

A Waste Book is just like a diary. It is kept for the sake of memory. The transactions are first recorded in the Waste Book in the manner in which they occur. Then at leisure (free time), appropriate entries are made in the journal. The transactions are recorded in the Waste Book as follows:

Date	Particulars	`
2011		
July 1	Started business with cash	18,000
7	Purchased goods from Y & Co.	900
10	Cash Sales	1200
14	Paid for Salaries	500
20	Rent paid	700

Meaning of Journal

The word *'Journal'* is derived from the French word *"Jour"* which means a day. Therefore, Journal means a 'daily record'.

Journal is a book where all the transactions are recorded (entered) first in a chronological or date wise order (in the order of their occurrence/taken place). Therefore, it is called as a book of first entry or a book of original entry or a book of prime entry.

In a journal, all types of business transactions are recorded systematically, by debiting one account and crediting another account.

The transactions are recorded in the journal on the basis of some documentary evidence which is called as a source document, such as cash memo, Invoice (Bill), receipt etc.

Journalizing

Recording of business transactions in the journal book on the basis of rules of double entry system is called as Journalizing. Journalizing means to enter or to record the business transactions in the journal book.

Steps in journalizing/Steps for converting transaction into Journal Entry/Procedure for Journalizing.:

1. Read the transaction carefully and find out what actually happened in the transaction.
2. Determine the nature of a transaction. Think of the effect of the transaction on the business.
3. Determine the two aspects of the transaction, *i.e.*, find out the two accounts involved.
4. Determine the types of accounts involved, *i.e.*, classify the affected accounts in Personal, Real and Nominal Account.
5. Apply the rule of debit and credit, looking at the type/class of account.
6. Apply the rule of Journalizing and decide which account is debited and which account is credited.
7. Record the transaction in journal by debiting one account and crediting another account.

Journal Entry: The record of a business transaction in a journal is called as journal entry.

Note: 'Journalizing' means recording a transaction in a journal and the form in which it is recorded is called 'Journal Entry'.

Narration: It means a brief explanation (description) of the Journal Entry. Narration is written on the next line of entry in bracket. It is started with the word "being". Narration shows the reason for passing of the Journal Entry. A journal entry without a proper narration is incomplete.

IMPORTANCE AND UTILITY OF JOURNAL

1. **Complete Record of Transaction:** A complete record of all transactions is available at one place, *i.e.*, in journal.
2. **Quick Reference:** Business transactions are recorded in chronological (date wise) order in journal. Therefore, it facilitates quick and easy reference to any transaction.
3. **Proper Understanding:** Narration of the transaction is given below each entry. It helps to understand recorded transaction (Journal Entry) properly.
4. **Avoids the Necessity of Immediate Posting:** Transactions are recorded in systematic manner in Journal. Therefore, there is no urgency to post them to the ledger.
5. **Evidence in the Court:** As the entries in the journal are made from source documents like receipts, voucher etc., the court considers the entries in the journal as a proof (evidence) of transactions. It acts as legal evidence (proof) in the court of Law.
6. **Minimum Errors (Mistakes):** We can ensure arithmetical accuracy because journal records debit and credit aspects of all the transactions. If errors are committed, they can be located immediately with the help of journal.

Format/Specimen/Proforma/Ruling of Journal

Date	Voucher No.	Particulars	L.F.	Debit (`)	Credit (`)
Year Month/ Date		Name of the A/c debited Dr. To Name of the A/c credited (Narration of the entry)		xx	xx

EXPLANATION OF COLUMNS OF JOURNAL

1 **Date:** Date Column is the first column from the left. It records year, month and the date of every transaction.

2 **Particulars:** In this column, the names of the accounts to be debited and credited are written. After debiting and crediting the accounts, narration is written in bracket.

In short, Journal entry and narration are written in Particulars column.

3 **L.F. (Ledger Folio):** Folio means page number and therefore, ledger folio means page number of ledger.

While recording the transactions in journal nothing has to be written in this (L.F.) Column. The Journal entries are required to be posted in the Ledger. At that time, the page number of the ledger on which the two accounts appear are entered in this column. Usually, these page numbers are written in red ink.

4 **Debit Amount (`):** In this column, amount of debit account is written.

5 **Credit Amount (`):** In this column, amount of credit account is written.

JOURNAL VOUCHERS

The details of each transactions are recorded on a separate sheet of paper which is known as a Voucher. This Voucher is given a serial number and this number is known as Journal Voucher Number. The number is entered in second column. The Journal Voucher must be signed by an authorized person. The Journal entry is passed on the basis of the Vouchers, under the authentication of the authorized person.

PRACTICAL PROBLEM FOR JOURNAL

Illustration 18

Journalize the following transactions with narration in the books of Mr. Pritesh.

2014

Feb. 1 Purchase goods from Mr. Z of ` 15,000.
3 Cash purchases ` 3,000.
6 Sold goods worth ` 7,000.
10 Purchased goods from Mr. A of ` 2,500.
12 Paid to Mr. A ` 1,500 on account.
18 Sold goods to Mr. D of ` 4,000.
22 Received from Mr. D ` 3,000 on account.
25 Goods returned to Mr. A of ` 500 & balance paid in cash.
27 Rent paid ` 500.

Journal of Mr. Pritesh

Date	**Voucher No.**	**Particulars**	**L.F.**	**Debit (`)**	**Credit (`)**
Feb.'14 1		Goods/Purchase A/c Dr. To Mr. Z's A/c (Being goods purchase on credit)		15,000	 15,000
3		Goods/Purchase A/c Dr. To Cash A/c (Being goods purchase for cash)		3,000	 3,000
6		Cash A/c Dr. To Goods/Sales A/c (Being goods sold for cash)		7,000	 7,000
10		Goods/Purchase A/c Dr. To Mr. A's A/c (Being goods purchase on credit)		2,500	 2,500
12		Mr. A's A/c Dr. To Cash A/c (Being cash paid on A/c)		1,500	 1,500
18		Mr. D's A/c Dr. To Goods/Sales A/c (Being goods sold on credit)		4,000	 4,000
22		Cash A/c Dr. To Mr. D's A/c (Being cash received on A/c)		3,000	 3,000
25		Mr. A's A/c Dr. To Goods/Purchase Return A/c (Being goods returned)		500	 500
25		Mr. A's A/c Dr. To Cash A/c (Being cash paid on A/c)		500	 500
27		Rent A/c Dr. To Cash a/c (Being rent paid)		500	 500
		Total		**37,500**	**37,500**

Journal of Mr. Pritesh

Date	Voucher No.	Particulars	L.F.	Debit (`)	Credit (`)
Feb.'14					
1		Goods/Purchase A/c Dr.		15,000	
		To Mr. Z's A/c			15,000
		(Being goods purchase on credit)			
3		Goods/Purchase A/c Dr.		3,000	
		To Cash A/c			3,000
		(Being goods purchase for cash)			
6		Cash A/c Dr.		7,000	
		To Goods/Sales A/c			7,000
		(Being goods sold for cash)			
10		Goods/Purchase A/c Dr.		2,500	
		To Mr. A's A/c			2,500
		(Being goods purchase on credit).			
12		Mr. A's A/c Dr.		1,500	
		To Cash A/c			1,500
		(Being cash paid on A/c).			
18		Mr. D's A/c Dr.		4,000	
		To Goods/Sales A/c			4,000
		(Being goods sold on credit)			
22		Cash A/c Dr.		3,000	
		To Mr. D's A/c			3,000
		(Being cash received on A/c)			
25		Mr. A's A/c Dr.		500	
		To Goods/Purchase Return A/c			500
		(Being goods returned)			
25		Mr. A's A/c Dr.		500	
		To Cash A/c			500
		(Being cash paid on A/c)			
27		Rent A/c Dr.		500	
		To Cash A/c			500
		(Being rent paid)			
		Total		**37,500**	**37,500**

Illustration 19

Journalize the following transactions in the books of Mr. Kalpesh.

2014

January 1 Mr. Kalpesh started diamond business with cash ` 10,00,000.

5 Mr. Kalpesh bought a raw stones of ` 4,50,000 as his capital.

8 Sold diamonds to Mr. Rahul for ` 7,00,000.

10 Purchased an Air condition for business ` 70,000.

13 Mr. Rahul paid cash ` 4,00,000 on A/c.

15 Paid labor charges ` 85,000.

18 Received commission ` 35,000.

22 Received cash from Mr. Rahul ` 2,80,000.

25 Paid electricity bill ` 3,000.

26 Diamond packet sold for ` 1,25,000.

30 Balance amount due from Mr. Rahul is not recoverable.

31 Withdraw for personal use ` 1,00,000.

Date	Voucher No.	Particulars	L.F.	Debit (`)	Credit (`)
Jan.'14 1		Cash A/c Dr. To Capital A/c (Being business started with cash)		10,00,000	10,00,000
5		Goods/Purchase A/c Dr. To Capital A/c (Being goods bought as a capital)		4,50,000	4,50,000
8		Mr. Rahul's A/c Dr. To Goods/Sales A/c (Being goods sold on credit)		7,00,000	7,00,000
10		Fixed Asset A/c Dr. To Cash A/c (Being air condition purchased for business)		70,000	70,000
13		Cash A/c Dr. To Mr. Rahul's A/c (Being cash received on A/c)		4,00,000	4,00,000
15		Labor Charges/Wages A/c Dr. To Cash A/c (Being labor charges paid)		85,000	85,000
18		Cash A/c Dr. To Commission A/c (Being commission received)		35,000	35,000

22		Cash A/c Dr. To Mr. Rahul's A/c (Being cash received on A/c)		2,85,000	2,85,000
25		Electricity A/c Dr. To Cash A/c (Being electricity bill paid)		3,000	3,000
26		Cash A/c Dr. To Goods/Sales A/c (Being good sold for cash)		1,25,000	1,25,000
30		Bad Debts A/c Dr. To Mr. Rahul's A/c (Being amount written off as a bad debts)		15,000	15,000
31		Drawings A/c Dr. To Cash A/c (Being amount withdraw for personal use)		1,00,000	1,00,000
		Total		**32,68,000**	**32,68,000**

Illustration 20

During January 2014, Narayan transacted the following business:

Dates		`
1	Commenced business with cash	40,000
2	Purchased goods on credit from Shyam	30,000
3	Purchased goods for cash	1,000
4	Paid Gopalan an advance for goods ordered	2,000
5	Received cash from Murthy as advance for goods ordered by him	3,000
6	Purchased furniture for goods for office use for cash	2,000
7	Paid wages	500
8	Received commission (in cash)	600
9	Goods returned to Shyam	200
10	Goods sold to Kamal	10,000
12	Paid for postage and telegrams	200
13	Goods retuned by Kamal	500
15	Paid for stationery	200
18	Paid into bank	500
20	Goods sold for cash	750
22	Bought goods for cash	1,000
25	Paid salaries	700
28	Paid rent	500
31	Drew cash for personal use	1,000

Solution

Journal Entries

Date	Particulars	L.F.	Debit `	Credit `
Jan 1	Cash Account Dr. To Narayan's Capital Account (Being the cash brought into business as capital) (*Logic:* Cash is a real account. Debit what comes in. Proprietor's capital is a personal account. Credit the giver.)		40,000	40,000
Jan 2	Purchases Account Dr. To Shyam's Account (Being the goods purchased on credit) (*Logic:* Purchases is expenses. Debit all expenses. Shyam is a personal account. Credit the giver.)		30,000	30,000
Jan 3	Purchases Account Dr. To Cash Account (Being the goods purchased for cash) (*Logic:* Purchases is expenses. Debit all expenses. Cash is a real account. Credit what goes out.)		1,000	1,000
Jan 4	Gopalan's Account Dr. To Cash Account (Being the amount paid to Gopalan) (*Logic:* Gopalan is a personal account. Debit the receiver. Cash is a real account. Credit what goes out.)		2,000	2,000
Jan 5	Cash Account Dr. To Murthy's Account (Being the cash received from Murthy) (*Logic:* Cash is a real account. Debit what comes in. Murthy is a personal account. Credit the giver.)		3,000	3,000
Jan 6	Furniture Account Dr. To Cash Account (Being the furniture purchased for office use for cash) (*Logic:* Furniture is a real account. Debit what comes in. Cash is a real account. Credit what goes out.)		2,000	2,000
Jan 7	Wages Account Dr. To Cash Account (Being the wages paid)		500	500

	(*Logic:* Wages is a nominal account. Debit all expenses. Cash is a real account. Credit what goes out.)			
Jan 8	Cash Account Dr. To Commission Received Account (Being the commission received) (*Logic:* Cash is a real account. Debit what comes in. Commission (received) is a nominal account. Credit all incomes.)		600	600
Jan 9	Shyam's Account Dr. To Purchase Returns Account (Being goods returned to Shyam) (*Logic:* Shyam is a personal account. Debit the receiver. Purchase returns is nominal a/c. Credit all income.)		200	200
Jan 10	Kamal's Account Dr. To Sales Account (Being goods sold to Kamal on credit) (*Logic:* Kamal is a personal account. Debit the receiver. Sale is nominal account. Credit all incomes)		10,000	10,000
Jan 12	Postage & Telegrams Account Dr. To Cash Account (Being the amount paid for postage and telegrams) (*Logic:* Postage and telegrams is a nominal account. Debit all expenses. Cash is a real account. Credit the giver.)		200	200
Jan 13	Sales Return Account Dr. To Kamal's Account (Being the goods returned by Kamal) (*Logic:* Sales returns is nominal account. Debit all reduction in income. Kamal is a personal account. Credit the giver.)		500	500
Jan 15	Stationery Account Dr. To Cash Account (Being the amount paid for stationery) (*Logic:* Stationary is a nominal account. Debit all the expenses. Cash is a real account. Credit what goes out.)		200	200
Jan 18	Bank Account Dr. To Cash Account (Being the amount deposited into the bank) (*Logic:* Bank is a real account. Debit what comes in. Cash is a real account. Credit what goes out.)Dr.		500	500

Jan 20	Cash Account Dr. To Sales Account (Being the goods sold for cash) (*Logic:* Cash is a real account. Debit what comes in. Sales is income. Credit all income.)		750	750
Jan 22	Purchase Account Dr. To Cash Account (Being the goods purchase for cash) (*Logic:* Purchase is expenses. Debit all the expenses. Cash is a real account. Credit what goes out.)		1,000	1,000
Jan 25	Salaries Account Dr. To Cash Account (Being the amount paid as salaries) (*Logic:* Salaries is a nominal account. Debit all expenses. Cash is a real account. Credit what goes out.)		700	700
Jan 28	Rent Account Dr. To Cash Account (Being the rent paid) (*Logic:* Rent is a nominal account. Debit all the expenses. Cash is a real account. Credit what goes out.)		500	500
Jan 31	Narayan's Drawings Account Dr. To Cash Account (Being the cash drawn for personal use) (*Logic:* Personal drawing is a personal account. Debit the receiver. Cash is a real account. Credit what goes out.)		1,000	1,000

POSTING IN THE LEDGER ACCOUNTS

An account is a summarized record of all the transactions related to one person, firm or one type of asset or property or one type of expense or income.

The short form of the word Account is A/c.

An account is divided into two sides. The left hand side is called "Debit Side", and the right hand side is called the "Credit Side".

Head of an Account: Head of an account means the name of the account.

The name of an account is written at the top, followed by the word "Account", *e.g.*, an account relating to Mahesh Shah will bear the head "Mahesh Shah Account".

To Debit an Account: It means to record the transaction on the left hand side, *i.e.*, the debit side of an account.

To Credit an Account: It means to record the transaction on the right hand side, *i.e.*, the credit side of an account.

MEANING AND DEFINITION OF LEDGER

All the accounts are kept in one book which is known (called) as ledger. A book in which all accounts are kept is called as ledger. Ledger is a bound book of accounts. It is called as secondary book of accounts or principal (main) book of accounts or book of final entry. Transactions cannot be directly recorded in the ledger. Each entry from the books of prime entry, *i.e.*, Journal and Subsidiary books is posted in the ledger. Therefore ledger is a derived or secondary record. Ledger provides all accounting entries in a summarized form relating to various accounts. It is a set of accounts. *An account in ledger is called 'Ledger account'*. Separate accounts are opened for each head in the ledger book. Ledger contains Personal accounts, Real accounts and Nominal accounts. The ledger is a book containing (including) many ledger accounts. The number of ledger accounts depends upon the number of transactions of different nature and with different parties.

The term 'Ledger' is derived from the Dutch word 'Legger' which means to lie. Therefore, ledger means a book where the various account lie.

The definition of 'Ledger' as given in the Encyclopedia is as under:

"A group of accounts is known as a ledger."

Features of Ledger

1. Ledger is a book of secondary or final entry. It is a main book of account.
2. It is a derived or secondary record.
3. It is a king of books of accounts.
4. It keeps item wise and account wise record of business transactions and provides instant information.
5. It provides overall summary of the business transactions relating to persons, properties, expenses, incomes, profits and losses.
6. It provides base to prepare trial balance.
7. It facilitates cross checking of business transactions entered in the journal.

Need and Importance of Ledger

All the business transactions are first recorded in the Journal. However, from the journal, we are not able to know the perfect position regarding total dealings or balance of any person or anything. The journal gives a scattered information regarding a particular account. Thus, recording of transactions in journal only is not sufficient.

A businessman cannot get sufficient information about the business transactions from the journal. For example, the amount receivable from debtors, the amount payable to creditors, total payment on any head of expenses etc. In order to get above information, a ledger has to be maintained. Ledger is very useful or important for business. Need, Importance, usefulness or utility of ledger is shown from the following points.

1. Ledger provides classified information on various accounts like accounts of expenses, incomes, losses, gains, assets, persons etc. This information provided by ledger is useful for controlling the business.
2. Trial balance is easily prepared on the basis of balance shown by Ledger Account.
3. Businessman, management and the government take policy decisions on the basis of record maintained in the ledger.

4. All personal accounts in ledger would show how much money is payable to creditors and receivable from debtors.
5. All real account in ledger would show the value of assets and properties.
6. All nominal accounts in ledger would show the sources of income and the amount spent on various heads of expenses.
7. Ledger has great utility to a businessman as (because) it gives information about a particular account at one place.
8. Total amount receivable from the debtors or customers and total amount payable to the creditors or suppliers can be known easily and quickly from the ledger. Accordingly, a businessman prepares a plan for collection and payment of such dues.

Contains of Ledger Book or Nature of a Ledger

A Ledger book contains various accounts. A ledger is a bound book. It contains many pages which are called folios. Every page in a ledger is serially numbered. Page number allotted to an account is called ledger folio. Every ledger has an alphabetical Index. Index in ledger indicates the page number allotted to every account. The names of all the accounts are written in alphabetical order. This facilitates immediate reference. Index helps in tracing any account in ledger.

Specimen/Ruling/Format/Proforma of a Ledger Account

The format of an account varies depending upon the system following in an organization. The generally accepted forms are as under:

1. 'T' form of Account.
2. Statement form of Account OR Balance form of Account

1. 'T' Form of Account: Specimen of an account in 'T' form is as under

Specimen or Ruling or Standard Form or Proforma of Ledger Account

In the books of ________

Dr. **Name/Head of A/c** **Cr.**

Date	Particulars	Folio or J.F.	`	Date	Particulars	Folio or J.F.	`
	To "The Name of Credit A/c"				By "The Name of Debit A/c"		

Ledger Account is divided into two sides. The left hand side is known as debit side and the right hand side is known as credit side. Title (Name/Head) of the account is written at the top in the centre. The words 'Dr.' and 'Cr.' is written at the top on the left hand side corner and right hand side corner respectively. The columns 'Date', 'Particulars', 'J.F./Folio' and 'amount' appear on both the sides of a ledger account.

2. Statement Form of Account (Balance form of Account): Specimen of an account in Statement form is as under:

Date	Particulars	Folio or J.F.	`	Date	Particulars	Folio or J.F.	`
	To "The Name of Credit A/c"				By "The Name of Debit A/c"		

Nowadays, this form of account is used mostly in the computerized system of accounting. The features of statement form of account are stated as follows :

1. **Side:** It does not have two sides.
2. **Columns:** Statement form of account has the following six columns:
   - **(a) Date:** In this column, date of transaction is written.
   - **(b) Particulars:** In this column, the name of the other account affected in the entry is written.
   - **(c) Folio:** In this column, the page numbers of the journal or subsidiary book from where entry is transferred to the ledger.
   - **(d) Debit Amount:** In this column, amount of the transaction is written in figures.
   - **(e) Credit Amount:** In this column, amount of the transaction is written in figures.
   - **(f) Balance:** In this column, balance is written in figures after considering all the posting made therein.

LEDGER POSTING

The process of transferring entries from the books of prime entry (Journal and Subsidiary books) to ledger is called as posting (Ledger posting).

1. **Process/Procedure of Ledger Posting (from Journal to Ledger)**
   - **(a) Date Column:** Write date of the transaction as recorded in the journal.
2. **Particulars Column**

   On Debit Side: Write Name of Credited Account in the Journal entry after the word “To”.

   On Credit Side: Write Name of Debited Account in the Journal entry after the word “By”.
3. **J.F./Folio Column**

   Write page number of the journal from where the entry is posted.
4. **Amount column**

   Write the amount in the debit side from debit column of Journal and credit side from credit column of Journal.

BALANCING OF LEDGER ACCOUNTS

Meaning

At the end of a certain period (say a month, a quarter or a year), the businessman will be interested in knowing the position of a particular account. Therefore, he will find out the net balance of an account after considering the totals of both the sides. **The difference between the debit and credit totals is a balance of that account**.

‘Balancing’ means technique of finding out the net balance of an account.

Steps in Balancing

1. Make the total of both the sides of a ledger account on a rough sheet.
2. Find out (compute) the difference between the totals of both the sides.
3. This difference must be written on the lighter/shorter side of an account, by writing against it, in ‘Particular’ column as “By Balance c/d (c/f)” or “To Balance c/d (c/f)” as the case may be.

(a) If the debit side is heavier, the difference will appear (put) on the credit side as "By Balance c/d". This is known as debit balance of an account.

(b) If the credit side is heavier, the difference will appear (put) on the debit side of an account as "To Balance c/d". This is known as credit balance of an account.

(c) In case the total of debit is equal to the total of credit, then that account is said as 'Squared up' and it has nil balance.

4. Make the total of both sides. Now total of both the sides comes equal, *i.e.*, total of both sides agree with each other.
5. Total of both the sides must be appear in the same line.
6. Draw a single line above the totals and two lines below the totals.
7. Closing balance (*i.e*., balance c/d or c/f) always comes on the shorter or lighter side. Closing balance becomes the opening balance (*i.e*., balance b/d or b/f) always comes on the heavier side.

NOTES

1. If a personal account has debit balance, it means the amount due from outsider, *i.e.*, outsider is our debtor. If a Personal Account has credit balance, it means the amount due to outsider, *i.e*., outsider is our creditor.

   Personal Accounts may also have nil balance.
2. All the Real Accounts always have debit balance or Nil balance.
3. All the accounts of expenses and losses always have debit balances.
4. All the accounts of incomes and gains always have credit balance.
5. If debit side total is heavier, then net balance is debit balance.

   If credit side total is heavier, then net balance is credit balance (Debit balance comes when debit side's total is heavier and credit balance comes when credit side's total is heavier)

   If the total of debit is equal to the total of credit, then net balance is nil balance.

Why Balancing of Ledger Accounts?

1. Personal Accounts

These accounts are balanced for finding out whether a person is a debtor or a creditor. A debit balance on a personal account indicates that the person is our debtor. A credit balance on a personal account indicates that the person is our creditor. A zero balance on personal account indicates that the account has been closed. It means the person is neither debtor nor creditor of the firm. At the end of the year, the total debtors and total creditors are ascertained by balancing personal accounts.

2. Real Accounts

(a) Cash Account: The purpose is to find out cash at hand. Cash Account will always have a debit balance or no balance. It can never have a credit balance. But Bank Account may have a credit balance.

(b) Goods Account: The purpose is to find out total sales, total purchases, total returns etc. In the case of Goods Account like Sales Account, Purchase Returns Account, there is a credit balance. Purchase Account and Sales Returns Account will have a debit balance.

(c) Other Real Accounts: The purpose is to find out the value of each property on a particular date.

Real Accounts will generally have a debit balance. The debit balance shows the value of property in possession, a credit balance shows profit on disposal of property.

3. Nominal Accounts

The purpose is to find out the total amount spent on each type of expenditure, and the total amount of income earned from various sources.

A debit balance in a Nominal Account signifies a loss or an expense. A credit balance in a Nominal Account signifies an income or a gain. A zero balance in the account shows that income or gain is equal to expense or loss.

Now, let us prepare the ledger accounts based on the entries passed earlier. A separate account is opened in ledger for each account. All the debit entries and credit entries are duly entered. At the end, the accounts are properly balanced. In other words, the total of all debit entries is adjusted against the total of credit entries and balance is brought forward to the next accounting period.

Cash Book, Subsidiary Books and General Ledger

Cash Book

Date	Receipts	L.F.	Cash `	Bank `	Date	Payments	L.F.	Cash `	Bank `
1991					1991				
Jan					Jan				
1	To Capital A/c		40,000		3	By Purchase A/c		1,000	
5	To Murthy's A/c		3,000		4	By Gopalan A/c		2,000	
8	To Commission A/c		600		6	By Furniture A/c		2,000	
18	To Cash A/c	C		500	7	By Wages A/c		500	
20	To Sales A/c		750		12	By Postage &		200	
						Telegrams A/c		200	
					15	By Stationery A/c		500	
					18	By Bank A/c	C	1,000	
					22	By Purchase A/c		700	
					25	By Salary A/c		500	
					28	By Rent A/c		1,000	
					31	By Drawings A/c		34,350	500
			44,350	**500**	31	By Balance c/d		**44,350**	**500**

Note: The letter 'C' in the Ledger Folio column denotes a 'contra entry'. That is an entry for which the debit and credit aspects are found in the Cash Book itself.

Purchases Book

Date	Name of Supplier	L.F.	Inward Invoice No.	`
1991 Jan. 2	Shyam			30,000
			Total	**30,000**

Purchase Returns Book

Date	Name of Supplier	L.F.	Inward Invoice No.	`
1991 Jan. 2	Shyam			200
			Total	**200**

Sales Book

Date	Name of Supplier	L.F.	Outward Invoice No.	`
1991 Jan. 10	Kamal			10,000
			Total	**10,000**

Sales Return Book

Date	Name of Supplier	L.F.	Inward Invoice No.	`
1991 Jan. 13	Kamal			500
			Total	**500**

General Ledger

Dr. **Capital Account** **Cr.**

Date	Particulars	J.F. No.	`	Date	Particulars	J.F. No.	`
1991 Jan. 31	To Balance c/d		40,000	1991 Jan.1	By Cash A/c		40,000
			40,000				**40,000**
			40,000	Feb. 1	By Balance b/d		40,000

Dr. **Shyam's Account** **Cr.**

Date	Particulars	JF No.	`	Date	Particulars	J.F. No.	`
1991 Jan. 9	To Purchase Returns		200	1991 Jan.1	By Purchases A/c		30,000
Jan. 31	To Balance c/d		29,800				
			30,000				**30,000**
				Feb. 1	By Balance b/d		29,800

Dr. **Purchase Account** **Cr.**

Date	Particulars	J.F. No.	`	Date	Particulars	J.F. No.	`
1991 Jan. 2	To Shyam A/c		30,000	1991 Jan. 31	By Balance b/d		32,000

Jan. 3 Jan. 22	To Cash To Cash		1,000 1,000				
			32,000				**32,000**
Feb. 1	To Balance b/d		32,000				

Dr. Sales Account Cr.

Date	Particulars	J.F. No.	`	Date	Particulars	J.F . No.	`
1991 Jan. 31	To Balance c/d		10,720	1991 Jan. 13 Jan. 20	By Kamal's A/c By Cash		10,000 750
			10,750				**10,750**
				Feb. 1	By Balance b/d		10,750

Dr. Purchase Returns Account Cr.

Date	Particulars	J.F . No.	`	Date	Particulars	J.F. No.	`
1991 Jan. 31	To Balance c/d		200	1991 Jan. 9	By Shyam's A/c		200
			200				**200**
				Feb. 1	By Balance b/d		200

Dr. Sales Returns Account Cr.

Date	Particulars	J.F. No.	`	Date	Particulars	J.F. No.	`
1991 Jan. 13	To Kamal's A/c		500	1991 Jan. 31	By Balance c/d		500
			500				**500**
Feb. 1	To Balance b/d		500				

Dr. Gopalan Account Cr.

Date	Particulars	J.F. No.	`	Date	Particulars	J.F. No.	`
1991 Jan. 6	To Cash A/c		2,000	1991 Jan. 31	By Balance c/d		2,000
			2,000				**2,000**
Feb. 1	To Balance b/d		2,000				

Dr. **Wages Account** **Cr.**

Date	Particulars	J.F. No.	`	Date	Particulars	J.F. No.	`
1991				1991			
Jan. 7	To Cash A/c		500	Jan. 31	By Balance c/d		500
			500				**500**
Feb. 1	To Balance b/d		500				

Dr. **Commission Received Account** **Cr.**

Date	Particulars	J.F. No.	`	Date	Particulars	J.F. No.	`
1991				1991			
Jan. 1	To Balance b/d		600	Jan. 31	By Cash A/c		600
			600				**600**
				Feb. 1	By Balance b/d		600

Dr. **Kamal's Account** **Cr.**

Date	Particulars	J.F. No.	`	Date	Particulars	J.F. No.	`
1991				1991			
Jan. 10	To Sales A/c		10,000	Jan. 31	By Sales Returns A/c		500
				Jan. 31	By Balance b/d		9,500
Feb. 1	To Balance b/d		**10,000**				**10,000**
			9,500				

Dr. **Postage and Telegrams Account** **Cr.**

Date	Particulars	J.F. No.	`	Date	Particulars	J.F. No.	`
1991				1991			
Jan. 10	To Cash A/c		200	Jan. 31	By Balance c/d		200
			200				**200**
Feb. 1	To Balance b/d		200				

Dr. **Stationery Account** **Cr.**

Date	Particulars	J.F. No.	`	Date	Particulars	J.F. No.	`
1991				1991			
Jan. 15	To Cash A/c		200	Jan. 31	By Balance c/d		200
			200				**200**
Feb. 1	To Balance b/d		200				

Dr. Salaries Account Cr.

Date	Particulars	J.F. No.	`	Date	Particulars	J.F. No.	`
1991 Jan. 25	To Cash A/c		700	1991 Jan. 31	By Balance c/d		700
			700				**700**
Feb. 1	To Balance b/d		700				

Dr. Rent Account Cr.

Date	Particulars	J.F. No.	`	Date	Particulars	J.F. No.	`
1991 Jan. 28	To Cash A/c		500	1991 Jan. 31	By Balance c/d		500
			500				**500**
Feb. 1	To Balance b/d		500				

Dr. Drawings Account Cr.

Date	Particulars	J.F. No.	`	Date	Particulars	J.F. No.	`
1991 Jan. 31	To Cash A/c		1,000	1991 Jan. 31	By Balance c/d		1,000
			1,000				**1,000**
Feb. 1	To Balance b/d		1,000				

Dr. Murthy's Account Cr.

Date	Particulars	JF No.	`	Date	Particulars	JF No.	`
1991 Jan. 31	To Balance c/d		3,000	1991 Jan. 5	By Cash A/c		3,000
			3,000				**3,000**
				Feb. 1	By Balance b/d		3,000

Dr. Furniture Account Cr.

Date	Particulars	JF No.	`	Date	Particulars	JF No.	`
1991 Jan. 6	To Cash A/c		2,000	1991 Jan. 31	By Balance c/d		2,000
			2,000				**2,000**
Feb. 1	To Balance b/d		2,000				

Notes:

(i) In a specific ledger, Ledger A/c can never be debited on credited.

(ii) If Ledger A/c is having an opening balance, then it will start with the word "Balance b/d" (*i.e.*, brought down). However, if the Ledger A/c is having a closing balance, then it will close with the word "Balance c/d" (*i.e.*, carried down).

(iii) All closing balance of Ledger A/c is transferred to "Trial Balance" at the end of every financial year.

(iv) Trial Balance is a statement showing the list of accounts with their closing balance, *i.e.*, either debit or credit balance.

INTRODUCTION TO TRIAL BALANCE

Earlier, we learnt how about various secondary books that include purchase book, sales book, purchase return book, sales return book, bills receivable book, bills payable book, cash book and journal proper. Cash book is an important subsidiary book that records all cash receipts and payments during a particular period. Posting of entries in ledger and the procedure for balancing in ledger account was briefly dealt.

Now we have to deal with the meaning, the need of trial balance, and the methods of preparing trial balance. There are different types of errors. Students should be acquainted with types of errors and how they are rectified. There are certain errors that are disclosed in the trial balance while certain errors are not disclosed in the trial balance. Trial Balance is a statement of debit balances and credit balances that are extracted from ledger accounts on a particular date. It stands as a bridge between primary and secondary books on one hand and final statements of accounts on the other hand.

MEANING

Trial Balance is a statement containing the various ledger balances on a particular date. It is prepared to check the arithmetical accuracy of the posting of transactions to the ledger. It is a list of debit and credit totals or a list of debit and credit balances of all the ledger accounts prepared on any particular date to verify whether the entries in books of accounts are authentically correct. As the primary and secondary books are maintained on the double entry concept, the balances in the trial balance must tally.

A trial balance is not a part of books of account. It is drawn as a separate statement, and this becomes the source document for preparing external financial statement such as profit and loss account, cash flow statement and Balance Sheet.

OBJECTIVES OF PREPARING A TRIAL BALANCE

There are three objectives of preparing a trial balance.

(a) **To check the arithmetic accuracy of entries made.** In double entry, every debit has an equivalent credit. Even in General Journal, we have seen that the total of debits equals the total of credits. Similarly, if the debits and credits tally in a trial balance, it indicates that the books of account are arithmetically accurate.

(b) **Basis for financial statements.** As stated earlier, trial balance is a bridge between ledger and final statements. Trial balance facilitates in the preparation trading account, profit and loss account and balance sheet.

(c) **It is a summarized ledger.** The position of a ledger account is judged simply by looking at the trial balance. It is because, all ledger accounts, after being balanced, are grouped as those showing debit and those showing credit balances. The total of all debit balance is equal to total of all credit balance. If in any case, the trial balance does not tally, the difference is temporarily transferred to suspense account till such difference is rectified.

METHODS OF PREPARING A TRIAL BALANCE

Totals method and Balance method are the two techniques of preparing trial balance. In the first method, the totals of debits and credits of every account are shown in the trial balance. For instance, a cash account has a debit total of ` 45,000 and credit total of ` 35,000. Creditors has a debit total of ` 70,000 and credit total of ` 80,000. Both these totals are carried to trial balance.

Proforma of Trial Balance under Totals Method

Trial Balance as on _________

Debit Totals	`	Credit Total	`
Cash Creditors	45,000 70,000	Cash A/c Creditors	35,000 80,000
Total	**1,15,000**	**Total**	**1,15,000**

The same logic is applied for all other accounts.

Balance Method

In the Balance method, instead of transferring the totals of both debit and credit, the net balance of every account for example in case of cash account of ` 10,000 (45,000 – 35,000) is shown on the debit side of trial balance.

Cash Account

Particulars	`	Particulars	`
To _____ To _____ To Balance c/d	xxxx xxxx 10,000	By _____ By _____	xxxx xxxx
Total	**45,000**	**Total**	**45,000**
		To Balance b/d	10000

If the debit side is greater than the credit side the difference is termed as debit balance. Creditors have ` 70,000 as debit total and ` 80,000 as credit total. The closing balance is shown on the credit side.

Creditors Account

Particulars	`	Particulars	`
To ______ To Balance c/d	xxxx 10000	By ______	xxxx
Total	**80000**	**Total**	**80000**
		By Balance b/d	10000

If the credit side is greater than the debit side the difference is termed as credit balance.

Proforma of Trial Balance under Balance Method

Trial Balance as on _________

Particulars	Debit balance `	Credit Balance `
Cash Creditors	10,000	10,000
Total	**10,000**	**10,000**

In the second method, only the difference (debit balance/credit balance) is alone considered. The same principle is adopted for all the other accounts. In the first method, more details are revealed but it is cumbersome. The second method gives the gist of the account and hence the second method is popular.

PREPARATION OF TRIAL BALANCE

The following steps should be followed to prepare a Trial Balance.

(a) Prepare the ledger accounts

(b) Balance them at the end of accounting period

(c) Group all accounts showing debit balance and show them of left hand side of trial balance

(d) Group all those accounts showing credit balance and show them on the right hand side of trial balance.

(e) Total the debits and credits and they must be equal, whatever be the method of preparing the trial balance.

We can conclude that normally the balances are debit or credit according to following tabular summary.

Debit Balances	**Credit Balances**
Drawing A/c	Capital A/c
Purchases A/c	Sales A/c
Sales Return A/c	Purchase Return A/c
Opening Stock A/c	Income A/c
Expenses A/c	Bank Overdraft A/c
Real A/c or Property A/c	Bank Loan A/c
Bank A/c	Creditors A/c
Cash A/c	Lender's or Depositor's A/c
Debtors A/c	Advances from Customers A/c
Accounts of the Persons to Whom Loans are Given A/c	Reserves and Provident Funds A/c (except reserve for discount on creditors)
Advances to Supplier's A/c	
Investment A/c	

Illustration 21

On 31st March, 2008 the totals of debit and credit sides of various ledger accounts and receipts and payments sides of cash and bank columns of cash book of Ronak were as under:

Total of Debit Side `	**Name of the Account**	**Total of Credit Side `**
10,000	Capital	1,35,000
25,000	Drawings	–
15,000	Stock on 31st March, 2008	–
1,90,000	Purchases	4,000
–	Purchase Returns	18,000

6,000	Sales	2,45,000
13,000	Sales Returns	–
12,000	Expenses	–
3,05,000	Customers	2,50,000
2,00,000	Suppliers	2,35,000
1,00,000	Car	–
2,81,000	Dena Bank	2,75,000
43,000	Cash	38,000

You are asked to prepare gross trial balance of Ronak as on that date.

Solution

Ronak
Gross Trial Balance as on 31st March, 2008

Sr. No.	Account Head	L.F.	Dr. `	Cr. `
1	Ronak's Capital A/c		10,000	1,35,000
2	Ronak's Drawings A/c		25,000	–
3	Opening Stock		15,000	–
4	Purchases		1,90,000	4,000
5	Purchase Returns		–	18,000
6	Sales		6,000	2,45,000
7	Sales Returns		13,000	–
8	Expenses		12,000	–
9	Customers		3,05,000	2,50,000
10	Suppliers		2,00,000	2,35,000
11	Car		1,00,000	–
12	Dena Bank		2,81,000	2,75,000
13	Cash		43,000	38,000
			12,00,000	**12,00,000**

Trial Balance (Net Trial Balance)

Net trial balance is taken in the following stages:

1. Take totals of debit column of each ledger account.
2. Take totals of credit column of each ledger account.
3. Find out which of the totals is greater and the extent by which it is greater.
4. Take totals of receipts side of cash and bank columns.
5. Take totals of payments side of cash and bank columns.
6. Find out which of the total is greater and the extent by which it is greater.
7. Write the names of all accounts as per the ledger, and also cash and bank accounts as per the cash book onto a statement.
8. Enter in the trial balance the differences between the debit and credit sides of each ledger account, cash and bank accounts on that side on which the total is greater. Thus,

(a) If the total of the debit side of an account is ` 600 and the total of the credit side of the accounts is ` 400, enter ` 200 in the “debit” column of the trial balance, and

(b) If on the other hand, the total of the debit side of an account is ` 500 and the total of the credit side of the account is ` 800, enter ` 300 in the “credit” column of the trial balance; and

(c) If the total of the debit side is ` 1,000 and the total of the credit side also is ` 1,000, do not enter any figure in either the debit or the credit columns.

9. Take the total of the debit column.
10. Take the total of the credit column.

If should be noted that all the above steps should be taken as on one particular date.

Taking the facts of Illustration 20, let us process the data.

Sr. No.	**Account Head**	**L.F.**	**Total of**		**Heavier Balance**	
			Debit `	**Credit `**	**Debit Side `**	**Credit Side `**
1	Ronak’s Capital		10,000	1,35,000	–	1,25,000
2	Ronak’s Drawings		25,000	–	25,000	–
3	Opening Stock		15,000	–	15,000	–
4	Purchases		1,90,000	4,000	1,86,000	–
5	Purchase Returns		–	18,000	–	18,000
6	Sales		6,000	2,45,000	–	2,39,000
7	Sales Returns		13,000	–	13,000	–
8	Expenses		12,000	–	12,000	–
9	Customers		3,05,000	2,50,000	55,000	–
10	Suppliers		2,00,000	2,35,000	–	35,000
11	Car		1,00,000	–	1,00,000	–
12	Dena Bank		2,81,000	2,75,000	6,000	–
13	Cash		43,000	38,000	5,000	–
			12,00,000	**12,00,000**		

We can now prepare the trial balance.

Solution

Ronak’s Trial Balance as on 31st March, 2008

Sr. No.	**Account Head**	**L.F.**	**Dr. `**	**Cr. `**
1	Ronak’s Capital		–	1,25,000
2	Ronak’s Drawings		25,00	–
3	Opening Stock		15,000	–
4	Purchases		1,86,000	–
5	Purchases Returns		–	18,000
6	Sales		–	2,39,000
7	Sales Returns		13,000	–
8	Expenses		12,000	–
9	Customers		55,000	–

10	Suppliers		–	35,000
11	Car		1,00,000	–
12	Dena Bank		6,000	–
13	Cash		5,000	–
			4,17,000	**4,17,000**

Illustration 21

Gautam hands over to you his books of accounts for the year ended 31st March, 2008 and also the following gross trial balance as on that date:

Sr. No.	Account Head	L.F.	Dr. `	Cr. `
1	Customers		15,80,000	12,40,000
2	Suppliers		8,75,000	10,90,000
3	Fixed Assets		2,55,000	42,000
4	Stock on 31/3/2008		1,00,000	–
5	Cash		2,45,000	2,43,000
6	Bank of India		8,90,000	9,50,000
7	Bank of Baroda		5,80,000	5,75,000
8	Purchases		9,00,000	25,000
9	Sales		30,000	13,00,000
10	Purchase Returns		–	40,000
11	Sales Returns		50,000	–
12	Expenses		60,000	–
13	Interest		50,000	–
14	Lenders		2,00,000	5,00,000
15	Advances to Suppliers		2,65,000	55,000
16	Advances from Customers		1,20,000	1,30,000
17	Capital		3,00,000	3,10,000
			65,00,000	**65,00,000**

Gautam wants you to prepare his trial balance.

Solution

Gautam's Trial Balance as on 31st March, 2008

Sr. No.	Account Head	L.F.	Dr. `	Cr. `
1	Customers		3,40,000	2,15,000
2	Suppliers		–	–
3	Fixed Assets		2,13,000	–
4	Stock on 31/3/2008		1,00,000	60,000
5	Cash		2,000	–
6	Bank of India		–	–
7	Bank of Baroda		5,000	12,70,000

8	Purchases		8,75,000	40,000
9	Sales		–	–
10	Purchase returns		–	–
11	Sales returns		50,000	–
12	Expenses		60,000	3,00,000
13	Interest		50,000	–
14	Lenders		–	10,000
15	Advances to suppliers		2,10,000	10,000
16	Advances from customers		–	–
17	Capital		–	–
			19,05,000	**19,05,000**

Illustration 22

Pooja started business on 1st June, 2008 with cash balance of ` 5,000. The following transactions took place during June 2008:

Transaction	Dates	`
Cash Purchases	1st June	4,000
	5th June	5,000
	10th June	6,000
	15th June	6,000
	20th June	7,000
	25th June	7,000
	30th June	7,000
Cash Sales	1st to 4th June	5,200
	5th to 9th June	6,300
	10th to 14th June	6,400
	15th to 19th June	7,500
	20th to 24th June	7,500
	25th to 29th June	7,500
	30th June	1,500
Expenses	5th June	200
	10th June	300
	15th June	300
	20th June	300
	25th June	300
	30th June	300

You are asked to show ledger accounts and prepare gross and net trial balances as on 30th June, 2008.

Solution

Dr. **Cash A/c** **LF 1** **Cr.**

2008	Particulars	J.F.	`	2008	Particulars	J.F.	`
Jun. 1	To Capital A/c		5,000	Jun. 1	By Purchase A/c		4,000
4-7	To Sales A/c		5,200		“ “ “		5,000
5-9	“ “ “		6,300	5	“ Expenses A/c		200
10-14	“ “ “		6,400		“ “ “		300
15-19	“ “ “		7,500	10	“ Purchases A/c		6,000
20-25	“ “ “		7,500		“ “ “		6,000
25-29	“ “ “		7,500	15	“ Expenses A/c		300
30	“ “ “		1,500		“ “ “		300
				20	“ Purchases A/c		7,000
					“ “ “		7,000
				25	“ Expenses A/c		300
					“ “ “		300
				30	“ Purchases A/c		7,000
					“ Closing Balance		3,200
			46,900				**46,900**

Dr. **Pooja’s Capital A/c** **LF 2** **Cr.**

2008	Particulars	J.F.	`	2008	Particulars	J.F.	`
Jun. 30	To Balance c/d		5,000	Jun. 1	By Cash a/c		5,000

Dr. **Purchase A/c** **LF 3** **Cr.**

2008	Particulars	J.F.	`	2008	Particulars	J.F.	`
Jun. 1	To Cash A/c		4,000	Jun. 30	By Balance c/d		42,000
5	“ “ “		5,000				
10	“ “ “		6,000				
15	“ “ “		6,000				
20	“ “ “		7,000				
25	“ “ “		7,000				
30	“ “ “		7,000				
			42,000				**42,000**

Dr. **Expenses A/c** **LF 4** **Cr.**

2008	Particulars	J.F.	`	2008	Particulars	J.F.	`
Jun 1	To Cash A/c		200	Jun. 30	By Balance c/d		1,700
5	“ “ “		300				
10	“ “ “		300				
15	“ “ “		300				
20	“ “ “		300				

25	" " "		300				
30	" " "		300				
			1,700				**1,700**

Dr. **Sales A/c** **LF 5** **Cr.**

2008	Particulars	J.F.	`	2008	Particulars	J.F.	`
Jun. 30	To Balance c/d		41,900	Jun. 1-4	By Cash A/c		5,200
				5-9	" " "		6,300
				10-14	" " "		6,400
				15-19	" " "		7,500
				20-24	" " "		7,500
				25-29	" " "		7,500
				30	" " "		1,500
			41,900				**41,900**

Pooja's Trial Balance as on 30th June, 2008

Particulars	L.F.	Gross		Net	
		Dr. `	Cr. `	Dr. `	Cr. `
Cash	1	46,900	43,700	3,200	–
Pooja's Capital	2	–	5,000	–	5,000
Purchases	3	42,000	–	42,000	–
Expenses	4	1,700	–	1,700	–
Sales	5	–	41,900	–	41,900
		90,600	**90,600**	**46,900**	**46,900**

PROBLEMS ON SIMPLE CASH BOOK

1. Enter the following transactions in a simple cash Book of Mr. Deven and also post them to ledger.

2009

March

1 Started business with cash ` 25,000.

4 Purchased goods for cash ` 3,000.

7 Sold goods for cash worth ` 2,000.

10 Deposited into Bank ` 2,000.

14 Purchased goods from Mr. Suraj worth 10,000 and paid half the amount immediately.

17 Received interest ` 4,000.

19 Sold goods to Mr. Popatlal worth ` 5,000.

23 Paid rent of ` 1,000.

25 Received commission ` 3,000 from Mr. Keshavchandra.

27 Paid Life Insurance Premium of proprietor ` 2,500.

29 Cash purchases ` 3,000.

31 Cash sales ` 5,000.

2. Record the following transactions in a simple Cash Book of Mr. Mohit for the month March 2011.

2011

March

1 Started business with cash ` 55,000.

4 Opened a current account with bank and deposited ` 20,000.

7 Purchased goods for cash ` 15,000.

9 Paid electricity bill ` 1,000.

11 Invested in Government Bonds ` 3,000.

17 Sold goods for cash ` 7,000.

20 Paid life insurance premium of Mr. Mohit ` 2,400.

22 Purchased goods for cash ` 5,000 @ 10% trade discount.

23 Received dividend ` 4,000.

26 Paid for transport ` 760.

28 Received on account from Rahul ` 3,240.

31 Deposited into bank cash in excess of ` 4,000.

3. Journalize the following transactions in the books of Abhijit.

2014

June

1 Abhijit started business with ` 20,000.

4 Paid into State Bank of India ` 10,000.

9 Purchased goods from Kiran ` 5,500.

15 Goods sold for cash ` 4,500.

20 Total cash purchases ` 7,500.

21 Sold goods to Heena ` 5,000.

23 Received a cheque of ` 5,000 from Heena.

27 Withdrew from Bank for personal use ` 3,000.

28 Received commission ` 2,700.

30 Paid staff salaries ` 1,500.

4. Journalise the following transactions in the books of Mr. Piyush and post them in to ledgers

2014

Jan.1 Piyush started business with Machinery of ` 1,00,000.

10 Cash deposited into bank ` 20,000.

20 Salary paid by cheque ` 3,000.

25 Interest received by cash ` 7,000.

30 Commission paid ` 2,000.

5. Journalize the following transactions in the books of Mr. Jamshed.

2014

Dec.

1 Business started with cash ` 50,000, Machinery ` 40,000, Furniture ` 20,000, Loan from Ratan ` 10,000 and Bills payable ` 5,000.

5 Cash deposited into bank ` 10,000 for opening an account.

9 Goods purchased from Mr. Dhirubhai ` 50,000 at 10% T.D.

14 Sold goods to Mr. Mafatlal of ` 10,000 at 10% T.D. and 10% C.D. Half amount received in cash and other half received by cheque.

18 Paid salary ` 500, wages ` 200 and interest ` 300.

20 Received commission ` 1,000 and dividend ` 3,000 by cheque.

22 Goods purchased from Dhirubhai of ` 20,000 at 10% T.D. and 10% C.D. Half amount paid in cash.

25 Goods sold to Mr. Birla of ` 10,000 at 2% C.D. and 10% T.D. Received 1/4th amount in cash and 1/4th amount by cheque.

27 Paid salary ` 400, wages ` 300 and interest ` 100 by cheque.

29 Received commission from Mr. Anil ` 2,000.

30 Withdrawn for personal use from office cash ` 600 and from Bank ` 400.

6. Journalise the following transactions post them into ledger and prepare trial balance

2014

June1. Abhilasha started business with ` 20,000.

4. Paid into State Bank of India ` 10,000.

9 Purchased goods from Kiran ` 5,500.

15 Goods sold for cash ` 4,500.

20 Total cash purchases ` 7,500. Paid by Cash ` 5,000 & paid by cheque ` 2,500.

21 Sold goods to Heena ` 5,000.

23 Received a cheque of ` 5,000 from Heena.

27 Withdrew from Bank for personal use ` 3,000 & for office use ` 1,000.

28 Received commission ` 2,700.

30 Paid staff salaries ` 1,500 in cash & ` 2,000 by cheque.

EXERCISE

Short Answers

1. What are the contents of Journal?
2. Explain in brief the utility of Journal.
3. What is Compound entry?

Long Answers

1. What is the significance of Journal as a book of prime entry?
2. Why and when discount is allowed? How they are recorded?

Give one word, term or phrase for the following statements

1. The amount of discount which is deducted from an invoice.
2. An allowance made by the receiver of cash to the giver of cash who pays it.
3. An allowance or deduction made by a manufacturer or wholesaler to a retailer or purchaser of the catalogue price or invoice price.
4. The book of daily records
5. The process of recording transactions.
6. Account of proprietor.
7. Page of Journal.
8. Discount which is recorded in books of account
9. Discount which is not recorded in the books of account

[**Ans.:** 1. Trade discount, 2. Cash discount, 3. Trade discount, 4. Journal, 5. Journalization, 6. Capital, 7. Journal folio, 8. cash discount, 9. Trade discount.]

5

CHAPTER

Reconciliation and Rectification

BANK RECONCILIATION STATEMENT

The Bank Reconciliation Statement is an aid used to ensure the accuracy of transactions appearing in the bank columns of the cash book. Such transactions can be verified through an external record, namely, the bank statement received periodically from the banker. While the business keeps a record of its transactions through the bank columns in the cash book, the banker in turn maintains the bank's transactions with the business in his ledger. An extract from this ledger showing details of the transactions during a specified period is sent at frequent intervals by the bank to the business and this extract is referred to as a bank statement.

Reasons for Difference between Bank Balances as per Cash Book and Pass Book

The relationship between the customer and the banker is that of a creditor and a debtor. So, if the bank columns of the cash book show a debit balance as on a specified date, the bank statement should show an equal amount of credit balance as on that date and *vice versa*. However, the balances shown by the two independent records may not always agree due to the following:

(a) Cheques issued by the business to its suppliers or other parties may not have been presented for payment.

(b) Cheques received from customers and deposited may not have been collected by the banker.

(c) Deposits may have been directly made by the customers into the bank account of the enterprise.

(d) Collection charges, service charges and interest on overdraft charged by the banker. The business can ascertain the exact amount of charges and record them in the cash book only after the receipt of the bank statement.

(e) Interest credited by bank for the balance maintained with it and any other income such as interest on securities, dividend, etc. collected by the bank on behalf of the business can be ascertained only from the bank statement.

(f) Wrong entries made by the business in the cash book or errors committed by the bank in its ledger.

(g) Omission of entries in the two sets of books.

(h) Dishonour of customers Cheques deposited in the bank account.

The effect of each of these entries is explained below.

Cheques Issued But Not Presented for Payment: When a cheque is issued to a third party, it is entered in the cash book by crediting the Bank A/c resulting in reducing the bank balance in the depositor's books. But bank debits the customer's account only when the Cheque is presented by that third party. So, till it is presented and paid for, the bank's pass book shows more balance than shown by the depositor's cash book.

Cash Book (Bank Column only)

Date	Particulars	`	Date	Particulars	`
04.03.14	To Balance b/d	15,000.00	05.03.14	By Rajan Traders' A/c	2,00,000
			05.03.14	By Balance c/d	13,000.00
		15,000.00			**15,000.00**

Pass Book

Date	Particulars	Dr. (Withdrawn)	Cr. (Deposited)	Balance `
04.03.14	To Balance b/d			15,000.00 (cr)

Cheques Deposited and Remaining Uncollected: Whenever a cheque is received by a person from a third party and he deposits it in a bank, he will debit Bank A/c and credit the Third Party A/c in his own books. His bank balance (in cash book) is therefore increased. But bank will credit that cheque not when it is deposited but only when that amount has been realized. Until the cheque has been collected, the balance appearing in the pass book would be less than the balance in the Bank A/c of cash book.

Cash Book (Bank Column only)

Date	Particulars	`	Date	Particulars	`
05.05.14	To Balance b/d	10,000	05.03.14	By Balance c/d	15,000
07.05.14	To Mr. Balaram's A/c	5,000	05.03.14		
		15,000			**15,000**

Bank Statement

Date	Particulars	Dr. (Withdrawn)	Cr. (Deposited)	Balance `
04.03.14	To Balance b/d			10,000.00

So, balance as per bank statement is ` 5,000 less than the balance in the cash book.

Deposits Directly Made into Bank A/c of the Enterprise: If suppose a debtor credits the amount directly into the bank account of a company, the balance in the pass book increases without a corresponding increase in the cash book (bank column) until it receives the information from the bank.

Dr. Cash Book (Bank Column only) Cr.

Date	Particulars	`	Date	Particulars	`
	To Balance b/d	5,000		By Balance c/d	5,000
		5,000			**5,000**

Pass Book

Date	Particulars	Dr.	Cr.	Balance `
04.03.14	To Balance b/d		10,000	5,000
	By Cash			15,000

Bank Charges: Bank charges some amount from customer by way of incidental charges, collection charges, etc. These adjustments are shown in the pass book as and when they occur and hence the balance in the pass book decreases. Only when the customer collects his pass book and verifies it, he will not know about it and hence the balance in the bank column of cash book shown is more.

Dr. **Cash Book (Bank Column only)** **Cr.**

Date	Particulars	`	Date	Particulars	`
	To Balance b/d	3,000		By Balance c/d	3,000

Pass Book

Date	Particulars	Dr.	Cr.	Balance `
	To Balance b/d			3,000 (cr)
	By Cash	15	10,000	2,985 (cr)

Similarly, interest on deposits credited by the bank leads to an increase in balance in bank's pass book without corresponding increase in the cash book.

1. In addition to the above-mentioned transactions, the balances may not agree because of omission of entries in two sets of books.
2. Wrong entries made by the business in cash book or errors committed by the bank in its ledger.
3. Dishonour of customers cheques deposited in the bank account.

THE RECONCILIATION STATEMENT

On receipt of the bank statement, a comparison of the entries in the Cash Book with those appearing in the bank statement will help in identifying the items causing the difference in the two balances. While the difference due to (i) and (ii) above will be eliminated in the near future (that is, creditors will soon present their cheques for payment and customer Cheques will be collected by the bank in due course), the difference due to items (iii) to (v) can be eliminated only if such items are recorded in the cash book. In addition, the business must rectify any errors in the cash book, include any transactions omitted and record the dishonour, if any, of customers' cheques. After these adjustments have been recorded, a statement will be prepared to reconcile the balance as shown by the cash book with that shown by the pass book. This statement is referred to as Bank Reconciliation Statement. It must be understood that this reconciliation statement will generally contain details of:

(a) Cheques issued and not presented,

(b) Cheques deposited and remaining uncollected,

(c) Errors in the bank statement, and

(d) Omission of entries in the bank statement.

The bank reconciliation statement is, thus, an additional tool available to check the accuracy of the bank columns of the cash book.

Advantages of Bank Reconciliation Statement

(i) Error Detection: It helps in detection of errors of omission of transactions or wrong recording of transactions either by the bank or the business enterprises. Errors identified in the books by preparing BRS can be rectified.

(ii) Delay in Collection Revealed: The delay in the collection of cheques, bills, etc., if any, are revealed, when BRS is prepared. The matter can be pursued to avoid unnecessary delays in collection. It also helps the management to keep track of the cheques and bills sent for collection.

(iii) Completion of Cash Book: Business enterprises get information about bank charges, cheques dishonoured, direct payments, direct deposits, etc. from the bank statement only. Entries of the same are made in the cash book on the basis of bank statement. Thus, to complete the cash book, comparison and reconciliation of cash book and bank book is essential.

(iv) Chances of Embezzlements are Reduced: Periodical comparison of cash book and pass book keeps a check on the office staff. For example, entry for cash deposit is appearing in the cash book, but not in the pass book, indicates fraud being committed by the staff. This type of frauds come to light when Bank Reconciliation Statement is prepared.

STEPS IN PREPARATION OF BRS

1. Take the cash book or passbook balance as starting point. The following points have to be noted while taking the starting balance.
   (i) Debit balance as per cash book indicates favourable balance.
   (ii) Credit balance as per cash book means overdraft or unfavourable balance.
   (iii) Debit balance as per pass book means overdraft or unfavourable balance.
   (iv) Credit Balance as per pass book means favourable balance.

   If the starting point denotes a favourable balance as per cash book or pass book, take it as a positive figure. However, if the starting point denotes negative unfavourable balance, take it as a negative figure.
2. Adjust the starting point amount as per the information given and analyze its impact on the other balances.
3. After adjusting all the differences or errors, the balance as per the other book is obtained. If the final balance is positive, it denotes favourable balance (Debit balance as per cash book or credit balance as per the pass book). However, if the final balance is negative, it denotes the unfavorable balance or overdraft. (Credit balance as per cash book or debit balance as per pass book).

The following table summarizes the impact of various differences and errors on the starting balance.

Bank Reconciliation Statement

Item	`	`
Bank Balance as per Cash Book		*******
Or		
Overdraft balance as per Pass Book		
Add:		
1. Cheques issued but not cleared	*****	
2. Direct payments made by customers	*****	
3. Amount collected by bank (rent, dividends, interest, on investment, etc.)	*****	
4. Cheques deposited but omitted to be recorded in cash book	*****	

5. Wrong credit on the credit side of pass book	*****	
		*****
Less:		
1. Cheques deposited but not collected	*****	
2. Cheques paid into the bank but dishonoured	*****	
3. Bank charges and interest charges	*****	
4. Payments made by the banker on behalf of the trader	*****	
5. Cheques issued but not recorded in the cash book	*****	
6. Wrong entry on the debit side of the pass book	*****	
		*****
Bank Overdraft as per Cash Book		*****

Illustration 1

On March 31, 1991, the cash book of Prithvi Limited showed a bank balance (debit) of ` 48,500. However, the bank statement showed a credit balance of ` 53,900 as on the same date. A detailed comparison of entries revealed the following:

(a) Customers' cheques amounting to ` 8,450 had not been collected by the bank as on 31.3.1991.

(b) Certain cheques amounting to ` 8,850 had not been presented for payment as on 31.3.19 91.

(c) Bank charges of ` 1,000 and interest on investments of ` 2,500 collected by the banker appear only in the bank statement.

(d) A wrong credit of ` 2,500 in the bank statement.

(e) Swaroop Limited, a customer, had paid into the bank directly a sum of ` 3,000 on March 29, 1991. This has not been recorded in the Cash Book.

(f) A cheque for ` 2,000 received from Excel Limited, a customer, and deposited had been returned unpaid. The dishonour of this cheque has not been entered in the Cash Book.

Prithvi Limited will first pass the necessary rectification entries in the cash book and then prepare a reconciliation statement.

Cash Book of Prithvi Limited (Bank Columns only)

Date	Receipts	Bank `	Date	Payments	`
1991			1991		
March 31	To Balance b/d	48,500	March 31	By Bank Charges	1,000
March 31	To Interest Received	2,500	March 31	By Excel Ltd.	2,000
March 31	To Swaroop Ltd.	3,000	March 31	By Balance c/d	51,000
		54,000			**54,000**

Solution

Bank Reconciliation Statement as on March 31, 1991

Particulars	`	`
Bank Balance as per Cash Book		51,000
Add:		
1. Cheques Issued and Not Presented	8,850	11,350
2. Wrong Credit in the Bank Statement	2,500	
Less:		
1. Cheques Deposited and Remaining Uncollected		62,350
2. Bank Balance as per Bank Statement		8,450
Bank Balance as per Cash Book		53,900

Illustration 2

Mr. Q maintains two accounts known as Account No. 1 and Account No. 2 in Bank of Maharashtra. On 31st December, 1991, the overdraft as per pass book for Account No. 1 is ` 86,552. But the overdraft as per cash book is not the same, and on comparing the pass book and the cash book, he finds the following:

(i) Out of the total cheques of ` 7,400 deposited on 27th December, 1991, one cheque amounting to ` 2,650 was collected on 4th January, 1992.

(ii) Out of the total cheques of ` 12,560 issued on 22nd December 1991, two cheques of ` 1,500 each were not presented until 31st December, 1991.

(iii) A cheque amounting to ` 2,260 was sent to the supplier, through post on 29th December, 1991 and it is expected to reach him only after 3rd January, 1992.

(iv) Bank charges amounting to ` 63 and interest charges amounting to ` 262 have not yet been recorded in the cash book.

(v) Mr. Q has deposited a cheque in his Account No. 2, for ` 1,000 on 2nd December, 1991 was wrongly credited to account No.1 by the bank.

(vi) A cheque deposited on 15th December, 1991 for ` 500 was returned dishonoured by bankers on 2nd January, 1992.

(vii) A cheque of ` 200 issued for Account No.1 by mistake was recorded in bank column of the cash book for Account No. 2, and this cheque was presented for payment on 4th January, 1992.

From the above particulars, prepare a bank reconciliation statement to find out the Bank Overdraft as per cash book.

Solution

Bank Reconciliation Statement as on 31st December, 1991

Particulars	`	`
Bank Overdraft as per Pass Book		86,552
Add:		
1. Cheques issued but not presented for payment	3,000	
2. Cheque sent to the supplier through post, but has not reached him, hence, not presented for payment	2,260	
3. Cheque wrongly credited to Account No.1 by bank instead of Account No. 2	1,000	6,260
		92,812
Less:		
1. Cheques deposited but not yet collected by the bank	2,650	
2. Bank charges and interest not recorded in cash book	325	
3. Cheque deposited on 15th December, 1991, but not cleared by the until 31st December, 1991	500	3,475
Bank Overdraft as per Cash Book		8,933

Note: Item No. (vii), will not make impact as on 31st December, 1991, as it was presented for payment only on 4th January, 1992 and the cash book (Bank column) of Account No. 2 is affected and not Account No. 1.

Illustration 3

On 31, March, 2001, the Cash Book of a firm showed a balance at bank for ` 40,000. From the information given below, prepare a Bank Reconciliation Statement.

1. Cheques issued for ` 7,000 have not yet been presented at the bank for payment.
2. Cheques amounting to ` 8,000 were paid on 29th March but have not been credited by the bank.
3. One cheque for ` 2,500 was entered in the Cash Book on 31st March, but was banked on 2nd April.
4. A cheque from Suresh, for ` 3,000 paid in on 27th March was dishonoured but the advice of the dishonour was received only on the 2nd April, 2001.
5. Pass book included a bank charge, ` 100 on its debit side.
6. Pass book showed ` 2,500 collected by the bank as interest on securities.

Solution

Bank Reconciliation Statement as on March 31, 2001

Particulars	`	`
Balance as per Cash Book		40,000
Add:		
Cheques issued but not yet presented	7,000	
	2,500	9,500

Interest collected by the bank but not yet entered in the Cash Book		49,500
Less:		
Cheques paid in but not yet collected	8,000	
Cheques entered in Cash Book but not yet paid in	2,500	
Cheques dishonoured but not yet entered in Cash Book	3,000	
Bank charges not yet entered in Cash Book	100	13,600
Balance as per Pass Book		35,900

Illustration 4

On March 31, 2001, the cash book of Sai Apna Ltd. showed an overdraft balance of ` 12,500 and this balance did not agree with the balance as per bank statement. On verification, the following facts were discovered.

(a) A cheque for ` 3,400 deposited on March 24, 2001 was dishonoured by bankers on April 3, 2001.

(b) Bank charges amounting to ` 180 and interest charges amounting to ` 615 have not been recorded in the cash book.

(c) Certain cheques amounting to ` 7,250 have not been presented for payment as on March 31, 2001.

(d) Interest on investment of ` 2,000 collected by the banker appears only in the bank statement.

(e) The debit side of the cash book had been overcasted by ` 900.

You are required to find out the balance as per bank book.

Solution

Bank Reconciliation Statement of Sai Apna Ltd.

Particulars	`	`
Overdraft Balance as per Cash Book		12,500
Add:		
(a) A cheque deposited on March 24, 2001 dishonoured	3,400	
(b) Bank charges (entered only in pass book)	180	
(c) Interest on overdraft (entered only in pass book)	615	
(d) Adjustment of cash book	900	5,095
		7,405
Less:		
(a) Cheques issued but not presented for payment	7250	
(b) Interest on investment directly credited to bank account	2000	9250
Overdraft Balance as per Pass Book		8,345

Illustration 5

Prepare a Bank Reconciliation Statement as on 30th September, 1991 from the following entries in the Bank Column of the Cash Book and the corresponding Pass Book

Cash Book (Bank Column only)

Date	Particulars	`	Date	Particulars	`
Sept.			Sept.		
1	To Balance b/d	8,000	4	By Drawings	700
3	To Kamlesh	2,200	8	By Suresh	3,300
9	To Prabhu	1,500	12	By Salary	2,800
16	To Pawan	3,400	16	By Manish	1,700
23	To Satish	2,600	18	By Shyam	4,200
27	To Mohan	100	21	By Kapil	2,000
30	To Kapoor	350	26	By Seeta	1,100
			30	By Commission	100
			30	By Balance c/d	2,250
		18,150			**18,150**

Bank Pass Book

Date	Particulars	Debit `	Credit `	Balance
Sept.				
1	By Balance b/d			Cr. 8,000
4	To Cheque – Drawings	700		Cr. 7,300
5	By Cheque – Kamalesh		2,220	Cr. 9,500
9	To Cheque – Suresh	3,300		Cr. 6,200
11	By Cheque – Prabhu		1,500	Cr. 7,700
12	To Cheque – Salary	2,800		Cr. 4,900
17	To Cheque – Manish	1,700		Cr. 3,200
20	By Cheque – Satish		2,600	Cr. 5,800
30	By Dividend Received		900	Cr. 6,700
	To Bank Charges	15		Cr. 6,685
	To Electricity Bill	60		Cr. 6,625
	To Cheque – Commission	100		Cr. 6,525

Solution

Bank Reconciliation Statement as on 30. 9.1991

Particulars		`
Balance as per Bank Column of Cash Book		2,250
Add: Cheques Issued but not presented:		
Shyam	4,200	
Kapil	2,000	
Seeta	1,100	7,300
		9,550
Less: Cheque deposited but not cleared:		
Pawan	3,400	
Mohan	100	
Kapoor	350	3,850
		5,700
Add: Amount credited in Pass Book only:		
Dividend received		900
		6,600
Less: Amounts debited in Pass Book only:		
Bank charges	15	
Electricity bill	60	75
Balance as per Pass Book		6,525

Errors and their Rectification: An error is an unintentionally committed mistake. When the Trial Balance does not tally, it is a clear indication that there are some errors in the preparation of accounts. The errors may be committed at various stages:

1. Journalizing,
2. Posting,
3. Casting (totaling),
4. Balancing,
5. Transferring to trial balance and so on.

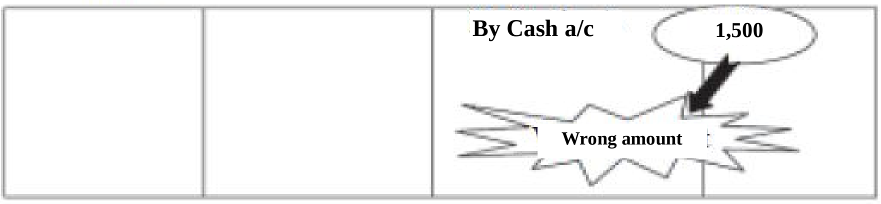
Mere tallying of the trial balance does not ensure an error free statement. There are certain errors such as errors of omission, error of principle and compensating errors are not disclosed by trial balance while errors of casting, posting to wrong side of an account or posting a wrong amount can be detected by trial balance.

Errors whether disclosed or not disclosed by trial balance have to be corrected or rectified in order to obtain the correct picture of profit or loss. It should be remembered that errors will have their impact not only on profit but also on the asset and liability position of the business organization.

Errors Disclosed by Trial Balance: Those errors that can be disclosed by trial balance can easily be located. As soon as the trial balance does not tally, the accountant can proceed to find out the spots where the errors might have been committed. The total amount of difference in the trial balance is temporarily transferred to a ‘Suspense Account’ so that it can be mitigated as and when the errors get rectified. Therefore, the suspense account gets debited or credited as the case may be on rectification of these types of errors. The following are the errors which are disclosed by trial balance:

(a) Posting a Wrong Amount: This mistake may occur while posting an entry from subsidiary book to ledger.

Example: Cash received from Rama ` 1,150 is posted to Rama's ledger account as ` 1,500 while it is correctly recorded in cash account.



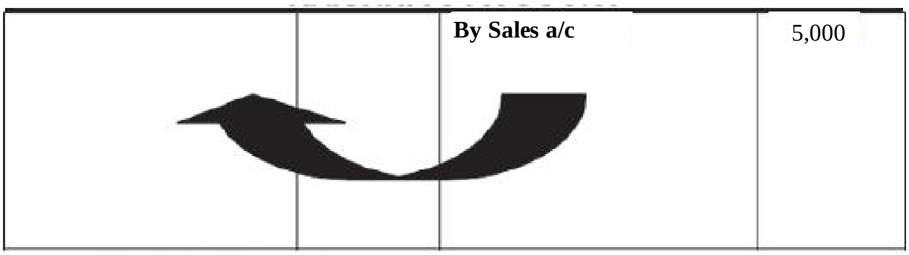
Rectification entry

Rama's account Dr. ` 350
To suspense account ` 350
(Being excess credit given to Rama's account rectified)

(b) Posting to the Wrong Side of an Account: This error is committed while posting entries from subsidiary books to ledger.

Example: Sales made to Krishna ` 5,000 is transferred to credit side of the Krishna's account in the ledger.

KRISHNA'S ACCOUNT



Rectification entry

Krishna's account Dr. ` 10,000
To suspense account ` 10,000
(Being excess in Krishana's account rectified)

(c) Wrong Totaling: Both undercasting and overcasting are detected by trial balance. If any account is wrongly totaled, it gets reflected in the trial balance.

Example: Purchase book total is ` 5,800. If it is totaled as ` 5,700 or ` 5,900, the difference will be shown in the trial balance.

PURCHASE BOOK	
ABC Ltd.	xxxx
MNC Ltd.	Xxxx
PQR Ltd.	Xxxx
Total	**5,800**

Trial Balance

	Debit	Credit
Cash		
Sales	xxx	
xxx		
Purchase	5,700	

Wrong Amount

(d) Omitting to Post an Entry from Subsidiary Book to Ledger: If an entry made in the subsidiary book does not get posted to ledger, the trial balance does not tally.

Example: Rent paid ` 2,000 recorded in cash account but is not posted to rent account at all.

RENTACCOUNT

To Cash A/c	2,000		

Omitted

Rectification entry

Rent A/c Dr. ` 2,000

To Suspense a/c ` 2,000

(Being the error of omitted to post rent paid in rent account rectified.)

(e) Omission of an Account Altogether from Being shown in Trial Balance:

Example: Advertisement account which shows a debit balance is completely omitted from trial balance

ADVERTISEMENT ACCOUNT

To Cash A/c	xxxx	By Balance c/d	xxxx
Total	xxxx	Total	xxxx

To balance b/d xxxx

TRIAL BALANCE

Particulars	Debit	Credit
Advertisement	Omitted	

Rectification entry

Advertisement Expense A/c Dr. ` 10,000
To Suspense A/c ` 10,000
(Being debit balance in advertisement account accounted)

(f) Posting an Amount to a Correct Account more than Once: This result in imbalance in the trial balance.

Example: Receipt from sundry debtors of ` 5,000 was accounted twice in sundry debtors account

SUNDRY DEBTORS A/c

		By Cash A/c By Cash A/c Entered Twice	50,000 50,000

Rectification entry

Suspense A/c Dr. ` 5,000
To Sundry Debtors A/c ` 5,000
(Being excess debit in sundry debtors account rectified)

(g) Posting an Item to the Same Side of Two Different Ledger Accounts: If two accounts are debited/credited for the same transaction, this type of error occurs.

Example: Furniture purchased should be debited to furniture account only. If it is posted to furniture account and purchases account, then the difference arises in the trial balance

FURNITURE ACCOUNT

		By cash a/c	xxx

PURCHASE ACCOUNT

		By cash a/c	xxx
		Omitted	

Rectification entry

Suspense a/c	Dr.	xxxx
To purchase a/c		xxxx
(Being wrong debit given to purchase account rectified)		

(h) Errors Not Disclosed by Trial Balance: There are four errors regarded as those which do not affect trial balance and it is difficult to locate them. A brief description of the four errors is offered in the following paragraphs:

(a) Error of Omission: Error of omission occurs when a transaction is completely omitted from the books of accounts.

Example: If purchase of goods from jairam on credit is not recorded at all either in the general journal or in the purchases book, it is termed as error of omission.

PURCHASE BOOK

Date	Supp-liers Name	LF	Inv. No.	`
	Jairam			

Ommitted

PURCHASE ACCOUNT

To Jairam	xxx		

Ommitted

Since both aspects — debit and credit — of the transaction are missing, the trial balance is not affected at all. To rectify such errors, the transaction should be recorded when it is traced.

(b) *Error of Commission:* If the error of wrong posting, wrong casting, wrong calculation etc., committed in the books of original entry or ledger, it is said to be error commission.

Example: Purchase invoice of ` 1,730 may have been entered as ` 1,370 in the purchases book it self, then, in the subsequent ledger accounts the same mistake continues and there by cannot be disclosed by trial balance.

The difference of ` 360 (1,730-1,370) should be added to purchases account and to the respective supplier's account.

Purchase Book

Date	Supp-liers Name	LF	Inv. No.	`
	xxx			1,370

Correct amount is ` 1,730

To cash	1,370		

Correct amount is ` 1,730

The error can be detected only when the original invoice is referred to after getting the complaint from the supplier.

Rectification entry

Purchase a/c Dr. 360

To Supplier a/c 360

(Being deficit amount added to rectify the account)

(c) *Error of Principle:* While drawing journal entries, often error of principle is committed and this goes unnoticed because it does not affect the total of trial balance.

Example:

Wages paid to workers engaged in the construction of building ???

1. Wages paid to workers engaged in the construction of building should be debited to building account but not wages account.
2. If the building account is debited, the value of the asset appears in the balance sheet and the expenditure is actually capitalized.
3. In case the wages are treated as usual revenue expenditure, they are deducted from profit.
4. The error here is wages account is debited and not building account

Rectification entry

Building a/c Dr.

To Wages a/c ` 10,000

(Being wrong debit given to wages account rectified)

Similarly, treating incomes as liabilities, providing insufficient provision for bad and doubtful debts, inadequate depreciation against assets etc., come under errors of principle. They must be rectified by applying the correct principles of accounting.

(d) Compensating Errors: It is also called off-setting error. Compensating error is one which is counterbalanced by another error.

Example:

1. Mr. X account was debited for ` 100 as against ` 1,000 while the account of Mrs. X account was debited ` 1,000 against the correct amount of ` 100.
2. The first error is compensated by the second error and therefore the trial balance is not affected this comes to light only at a later stage or on receipt of the complaint

Mr. X account			
Dr.			
To cash	100		

Instead of ` 1,000

Mrs. X account			
Dr.			
To cash	1000		

Instead of ` 100

Rectification entry

Mr. X account	Dr.	900
To Mrs. X account		900

(Being deficit amount debited in Mr. X account and excess amount debited in Mr.s X account rectified account rectified)

Steps to Locate the Errors: The following steps help to locate the errors. In spite of the efforts, if the difference in the trial balance persists, a suspense account may be created and subsequently the suspense account can be eliminated as and when the errors are located and rectification is made.

1. Check the totals of both debit side and credit side of the trial balance.
2. Check the totals of debtors and creditors accounts.
3. Find out whether all ledger balances are carried to trial balance.
4. Verify the totals of all the ledger accounts.
5. Divide the amount of difference in the trial balance by 2 and see if any item of the debit or credit side, equal to that amount has been posted to the opposite side.
6. Check whether the opening balances are brought down correctly from the previous accounting period.
7. Make a comparison with trial balance of the previous year to find out if there are any items missing.
8. Where the difference in the trial balance is divisible by 9 then the difference is likely to be due to misplacement of figures like 12 for 21; 24 for 42; 36 for 63 and so on.

When errors are located, they should be rectified. It is not a good practice nor do we have the legal right to erase the mistakes and rewrite the correct ones. Rectification entries are recorded in General journal or journal proper.

Example

Goods ` 3,000/- sold to Nishikant has been debited to M/s Nishi & Co. A/c.

Solution

Entry	L.F.	Dr.	Cr.
Wrong Entry			
M/s Nishi & Co.'s A/c Dr.		3,000	
To Sales A/c			3,000
Reverse Entry			
Sales A/c Dr.		3,000	
To M/s Nishi & Co. A/c			3,000
Correct Entry			
Nishikant's A/c Dr.		3,000	
To Sales A/c			3,000
Rectification Entry			
Nishikant's A/c Dr.		3,000	
To M/s Nishi & Co. A/c			3,000

Example

A credit purchase of `  3,000 from Nishikant is posted to his account as ` 30,000.

Solution

Entry	L.F.	Dr.	Cr.
Wrong Entry			
Purchase A/c Dr.		3,000	
To Nishikant's A/c			3,000
Reverse Entry			
Nishikant's A/c Dr.		3,000	
To Purchase A/c			3,000
Correct Entry			
Purchase A/c Dr.		3,000	
To Nishikant's A/c			3,000
Rectification Entry			
Nishikant's A/c Dr.		3,000	
To Purchase A/c			3,000

Example

A credit purchase from Nishi & Co. has been wrongly recorded in sales book ` 3,000/-.

Solution

Entry	L.F.	Dr.	Cr.
Wrong Entry M/s Nishi & Co. A/c Dr. To Sales A/c		3,000	3,000
Reverse Entry Sales A/c Dr. To M/s Nishi & Co. A/c		3,000	3,000
Correct Entry Purchase A/c Dr. To M/s Nishi & Co. A/c		3,000	3,000
Rectification Entry Purchase A/c Dr. Sales A/c Dr. To M/s Nishi & Co. A/c		3,000 3,000	3,000

Illustration 6

An accountant finds that the trial balance of his client did not tally and it showed an excess credit of ` 69.74. He transferred it to a suspense account and later discovered the following errors.

(a) ` 44.37 paid to Anand has been credited to his account as ` 34.37.

(b) A purchase of ` 145.50 has been posted as ` 154.50 to the purchases account.

(c) An expenditure of ` 158 on repairs has been debited to the Buildings account.

(d) ` 80 was allowed by B as discount which has not been entered in the books.

(e) A sum of ` 125.05 realized on the sale of old furniture has been posted to the sales account.

Give journal entries to rectify the errors.

Solution

Date	Particulars	L.F.	Debit (`)	Credit (`)
1	Anand's Account Dr. To Suspense Account (Being wrong amount, wrongly credited to Anand's A/c rectified)		78.74	78.74
2	Suspense Account Dr. To Purchases account (Being over debit of Purchase A/c rectified)		9.00	9.00

3	Repairs Account Dr. To Building Account (Being wrong debit given to building account rectified)		158.00	 158.00
4	B's Account Dr. To Discount Received Account (Being discount received from B, omitted earlier, brought to account)		80	 80
5	Sales Account Dr. To Old Furniture Account (Being sales of old furniture wrongly transferred to sales account rectified)		125.05	 125.05

Note:

1. The entry should have been:

   Anand A/c Dr. 44.37

   To Cash A/c 44.37

   (Being cash paid to Anand accounted)

   When amount is paid to Anand, his account should have been debited. On the other hand, his account was credited for a wrong amount of ` 34.37. Hence, there has been excess credit to the extent of ` 78.74 (44.37 + 34.37). To rectify this double error we need to debit Anand's account to the extent of ` 78.74 and credit suspense account.
2. Purchases account was overdebited by ` 9 (` 154.50 – ` 145.50). To rectify this error, we need to credit purchase account to the extent of ` 9 and debit suspense account.
3. Repairs spent on building are by mistake debited to building account. This is error of principle. Repairs account is debited and buildings account is credited to rectify the error.
4. Discount received from B has not been taken to records. This is an error of omission. Therefore, it is now brought to accounts. This has not affected the trial balance.
5. When old furniture is sold, the furniture account should have been credited. On the other hand, sales account was credited against to the principle of accounting. To rectify the error, sales account is debited and old furniture account is credited.

Illustration 7

The trial balance of Evergreen Co. Ltd. taken out as on 31st December, 2002 did not tally and the difference was carried to suspense account. The following errors were detected subsequently.

(a) Sales book total for November was undercast by ` 1,200.

(b) Purchase of new equipment costing ` 9,475 has been posted to Purchases A/c.

(c) Discount received ` 1,250 and discount allowed ` 850 in September 2002 have been posted to wrong sides of discount account

(d) A cheque received from Mr. Longford for ` 1,500 for goods sold to him on credit earlier, though entered correctly in the cash book has been posted in his account as ` 1,050.

(e) Stocks worth ` 255 taken for use of Mr. Dayananda, the Managing Director, has been entered in sales day book.

(f) While carrying forward, the total in Returns Inwards Book has been taken as ` 674 instead of ` 647.

(g) An amount paid to cashier, Mr. Ramachandra, ` 775 as salary for November month has been debited to his personal account as ` 757.

(h) Pass journal entries and draw up the suspense account.

Solution

Journal Proper of Evergreen Co. Ltd.

Date	Particulars		L.F.	Debit (`)	Credit (`)
31.12.2002	Suspense Account	Dr.		1,200	
	To Sales Account				1,200
	(Being undercasting of sales book rectified)				
31.2.2002	New Equipment Account	Dr.		9,475	
	To Purchases Account				9,475
	(Being wrong debit given to purchase account rectified)				
31.12.2002	Discount Allowed Account	Dr.		1,700	
	Suspense Account	Dr.		800	
	To Discount Received Account				2,500
	(Being discount received and discount allowed posted to wrong side of discount account rectified)				
31.12.2002	Suspense Account	Dr.		450	
	To Longford Account				450
	(Being short credit given to Longford Account)				
31.2.2002	Sales Account	Dr.		255	
	To Suspense Account				255
	(Being stock used for personal purpose wrongly credited to sales account rectified)				
31.2.2002	Suspense Account	Dr.		27	
	To Return Inwards Account				27
	(Being excess debit given to return inwards account to the extent of ` 27 now rectified)				
31.2.2002	Salary Account	Dr.		775	
	To Ramachandra's Account				775
	To Suspense Account				18
	(Being the wrong debit of salary to the personal account of Ramachandra now rectified)				

Note:

In Q. No. (c): Discount received ` 1,250 is posted on the wrong side of discount account. Discount received (income) should be credited and discount allowed (expenses) should be debited. Instead of crediting the discount received account, it has been wrong debited. To rectify this error, we need to credit discount received account to the extent of ` 2,500 (` 1,250 + ` 1,250).

In the same context, discount allowed which is an expense should be debited instead, it is credited. To rectify the error, we need to debit discount allowed to the extent of ` 1,700 (850 + 850). The difference between discount received and discount allowed account is transferred to suspense account.

Illustration 8

The trial balance of M/s J Ltd. on 31st March, 1991 did not balance. The difference amount of ` 76 was transferred to the credit of suspense account, and the accountant proceeded with the preparation of final accounts. Before completion of final accounts, the following errors were discovered:

(a) Total of sales figure was taken as ` 58,726 instead of ` 58,762.

(b) A discount of ` 52 allowed to Mr. X was not recorded in the discount allowed account.

(c) The total of purchases returns book was undercast by ` 43.

(d) Sale of old furniture for ` 130 was wrongly entered in Machinery A/c.

(e) A credit purchase for ` 49 made from Mr. Y was recorded in purchases book, but was omitted to record in Y's account.

(f) ` 320 received from P was posted to the credit of R.

(g) A credit sale made to Mr. S for ` 250 was recorded twice in his account.

(h) Depreciation on plant and machinery was wrongly recorded as ` 750, instead of ` 950.

(i) ` 50 wages paid on 30th March, 1991, are not debited to wages account.

Give journal entries to rectify the above errors, and prepare suspense account.

Solution

Rectification of Errors

Sr. No.	Particulars	L.F.	Debit (`)	Credit (`)
(a)	Suspense A/c Dr. To Sales A/c (Being the sales figure undercast by ` 36)		36	 36
(b)	Discount Allowed A/c Dr. To Suspense A/c (Being the discount allowed not recorded earlier)		52	 52
(c)	Suspense A/c Dr. To Purchase Returns A/c (Being the total of purchase returns undercast by ` 43)		43	 43
(d)	Machinery A/c Dr. To Furniture A/c (Being the sale of furniture wrongly credited to Machinery A/c earlier)		130	 130
(e)	Suspense A/c Dr. To Y's A/c (or Creditor's A/c) (Being the credit purchase made from Y was not recorded in his account)		49	 49
(f)	R's A/c Dr. To P's A/c (Being the entry to rectify the wrong credit given to R instead of P)		320	320

(g)	Suspense A/c Dr. To S's A/c (Being the entry to rectify the error of debiting S twice)		250	 250
(h)	Depreciation A/c Dr. To Suspense A/c (Being the entry to record depreciation figure correctly)		200	 200
(i)	Wage A/c Dr. To Suspense A/c (Being the entry to record the wages, which was not recorded earlier)		50	 50

Illustration 9

The accountant of Jay Ltd. has reconciled the trial balance by putting the difference in a suspense account and has prepared a trading and profit and loss account and balance sheet. Subsequent scrutiny of the books disclosed the following errors:

(a) A credit sale of goods to Mr. Roshan for ` 2,100 has been credited to his account.

(b) Goods purchased from Mr. Kanithkar amounting to ` 1,200 were entered in the purchase day book, but were omitted to be entered in the name of Mr. Kanithkar in the creditors ledger.

(c) Office furniture purchased for ` 2,100 has been passed through the purchase account.

(d) Repairs to office car amounting to ` 850 were debited to the office car account.

You are required to:

(a) Pass the journal entries for rectification of the above errors.

(b) Prepare suspense account.

Solution

Jay Ltd.
Journal Entries

Sr. No.	Particulars	L.F.	Debit (`)	Credit (`)
(a)	Mr. Roshan's Account (` 2,100 × 2) Dr. To Suspense Account (Being sales to Mr. Roshan wrongly credited to his account, now rectified)		4,200	 4,200
(b)	Suspense Account Dr. To Mr. Kanithkar's Account (Being purchase from Mr. Kanithkar omitted to be posted to his account in the ledger, now rectified)		1,200	 1,200
(c)	Office Furniture Account Dr. To Profit & Loss Adjustment Account (Being purchase of office furniture wrongly passed through the purchase day book, now rectified)		2,100	 2,100

(d)	Profit & Loss Adjustment Account Dr. To Office Car Account (Being repairs to office car wrongly debited to office car account, now rectified)		850	 850

Illustration 10

In the month of April 2002, the accountant of Mapani & Co. found the following errors in the books of accounts for the year 2001-02 in spite of the agreed balance sheet:

(i) A sale of ` 20,050 to Mr. Dutta was entered in the sales day book as ` 20,500 and it has been debited to Mr. Dutta's account as ` 25,000.

(ii) A purchase of ` 16,000 from Mr. Philip on 30th March 2002 was taken in stock, but the invoice was not passed through the purchase day book.

(iii) Goods to the value of ` 2,750 returned by Mr. Rajkumar had been debited to his account and also to sales return account.

(iv) The purchase day book for the month of March 2002 was undercast by ` 10,000.

(v) Bank interest on overdraft for the month of March 2002, amounting to ` 3,750 has not been recorded in the books of accounts.

(vi) A credit sale of ` 20,000 on 29th March 2002, has been completely omitted from the sales day book.

You are required to pass the necessary journal entries to rectify the above errors.

Solution

Mapani & Co.
Journal Entries

Sr. No.	Particulars	L.F.	Debit (`)	Credit (`)
(a)	Profit & Loss Adjustment A/c Dr. Suspense A/c Dr. To Mr. Dutta's A/c (Being sale to Mr. Dutta of ` 20,050 wrongly entered in the sales book as ` 20,500 and posted to his account as ` 25,000 now rectified)		450 4,500	 4,950
(b)	Profit & Loss Adjustment A/c Dr. To Mr. Philip's A/c (Being goods purchased on 30th March 2002 were included in stock but not recorded in the purchase book, now rectified)		16,000	 16,000
(c)	Suspense A/c Dr. To Mr. Rajkumar A/c (` 2,750 × 2) (Being goods returned by Mr. Rajkumar wrongly debited to his account, now rectified)		5,500	 5,500
(d)	Profit & Loss Adjustment A/c Dr. To Suspense A/c (Being error caused by undercasting of the purchase book in the month of March 2002, now rectified)		10,000	 10,000

(e)	Profit & Loss Adjustment A/c Dr. To Bank A/c (Being bank interest previously not recorded now rectified)		3,750	3,750
(f)	Sundry Debtors A/c Dr. To Profit & Loss Adjustment A/c (Being credit sales completely omitted from sales day book, now rectified)		20,000	20,000

EXERCISE

Self Assessment Questions

1. Normally, a trader's cash book shows a _______________ balance while his bank statement shows a ______________ balance.
2. A debit balance of the Pass Book represents ______________
3. Cheques deposited by a trader and cleared by the bank appear on the ______________ side of his Pass Book.
4. Cheques issued by a trader and encashed by his creditors are ______________ in his Pass Book.
5. Interest on overdraft is _______________ by the bank in the Pass Book.
6. Balance as per Cash Book and Pass Book are always equal.
7. A bank reconciliation statement is not prepared when the trader has no bank account.
8. Errors in the Cash Book or Pass Book cannot be found by preparing a Reconciliation Statement.
9. While reconciling the Cash Book and Pass Book Balance of the debit side. Cash Book is compared with the credit side of Pass Book and *vice versa*.
10. If the bank gives a bank statement instead of the Pass Book, no reconciling statement is necessary.
11. Errors can be committed at all stages, beginning from journal entries, posting of entries in ledger accounts, while balancing the closing balances etc.
12. Errors of omission, error of principle and compensating errors are not disclosed by trial balance.
13. Errors of casting, posting to wrong side of an account or posting a wrong amount etc. can be detected by trial balance.
14. Suspense account is the difference between debit total and credit total of a trial balance.
15. Suspense account is created temporarily and later, it is removed as and when errors are detected and suitable rectified.
16. If amount paid to Rama ` 500 is credited to Ramanan's account, what type of error has occurred and give the rectification entry.
17. Instead of putting ` 1,500 to debit of wages account, ` 15,000 is recorded. Identify the type of error and tell what impact it has on profit?
18. Refer Q. No.17. How do you rectify the above error?
19. If error of wrong posting, wrong casting, wrong calculation etc.are committed in the books of original entry or secondary books, such errors are called ________.

20. Error of commission affects trial balance.
21. Furniture purchased for cash ` 5,000/- is not recorded in journal. Mention the type of error?
22. Error of omission can be detected only after a careful review of ledger balances of previous years.
23. Error of principle affects the value of revenue and capital items.
24. It is very difficult to find out the compensating errors.
25. Summary of all ledger balances is called ______________________ .
26. Trial balance is necessary to prepare __________________________ .
27. The broad two categories of errors are: (a) ________________ (b) ____________.
28. Is casting error, an error of principle or error of commission?
29. Purchase of machinery is included in the purchases book. What type of error is it?
30. What is error of omission? Illustrate.
31. What are the errors that cannot be disclosed by trial balance?
32. The sum of errors in accounting is transferred temporarily to _________ account.
33. In which journal do you make rectification entries?
34. State any four steps to locate errors.
35. If sales account is undercast by ` 45, what is the rectification entry?
36. Return inwards book is overcast by ` 9. Write the rectification entry.
37. Salary paid to Gopal is debited to his personal account. What is the rectification entry to correct the error?
38. Discount received ` 50 is transferred to the debit side of discount account. Write the rectification entry.
39. An invoice of purchase for ` 760 is entered as ` 670. What type of error is this? How to rectify this error?

[**Ans:** 1. debit, credit, 2. overdraft, 3. credit,4. debited, 5. debited, 6. False, 7. True, 8. False, 9. True, 10. False, 11. True, 12. True, 13. True, 14. True, 15. True,

16. It is a wrong posting and hence it is error of commission.

Rama's A/c	Dr.	500	
Ramanan's A/c	Dr.	500	
To Suspense A/c			1,000

(Being amount paid to Rama wrongly credited to Ramanan's account rectified)

17. Posting of wrong amount - Trial balance is affected. Profit (gross) is reduced by ` 13,500,
18. Suspense A/c Dr. 13,500

Suspense A/c	Dr.	13,500	
To Wages A/c			13,500

(Being excess debit to wages account rectified)

19. Error of commission, 20. False, 21. Error of omission, 22. True, 23.True, 24. True, 25. Trial balance, 26. final accounts, 27. Error that are disclosed by trial balance and those which cannot be disclosed by trial balance, 28. Error of commission, 29. Error of principle, 30. Omitting completely a transaction from books of original entry. Sales made to Raghu of ` 12,000 completely ignored, 31. Error of omission, commission, principle, compensating error, 32. Suspense account, 33. Journal proper, 34. Four steps to locate the errors: (i) Check the total of both sides of trial balance, (ii) Total debtors and creditors accounts, (iii) Verify whether balancing is done correctly, (iv) Check the totals of ledger balances etc.

35. Suspense A/c Dr. 45
    To Sales A/c 45
    (Being sales account which was under cast rectified.)
36. Suspense A/c Dr. 9
    To Return Inwards A/c 9
    (Being returned inward book which was overcast rectified.)
37. Salary A/c Dr.
    To Gopal A/c
    (Being wrong debit given to Gopal rectified.)
38. Suspense A/c Dr. ` 100
    To Discount received A/c ` 100
    (Being wrong posting in discount received A/c rectified.)
39. This is an error of commission. By checking the original invoice document, it can be rectified.
    Purchase A/c Dr. ` 90
    To Creditors A/c ` 90
    (Being wrong posting in purchase book rectified.)]

Terminal Questions

1. On 31st March 2002, the cash book of Shri Bhima showed a balance of ` 24,000, but the bank pass book showed a different balance. On comparing the cash book with the pass book, the following discrepancies were noticed. Prepare a bank reconciliation statement as on 31st March, 2002.
   (i) Cheques issued on 26th March of ` 1,000, but were presented for payment on 5th April, 2002.
   (ii) Cheques of ` 900 were deposited into the bank, but they were collected on 1st April, 2002.
   (iii) Interest allowed by bank ` 300 but it was not recorded in the cash book.
   (iv) A customer directly deposited ` 500 into the bank account. The entry of the same was made in the cash book on 4th April 2002.
   (v) Bank debited the pass book by ` 25 for bank charges. The corresponding entry for the same was not found in the cash book.
   (vi) Under the standing instructions, the bank made the payment of telephone bill of ` 225 on our behalf. No corresponding entry was found in the cash book.
2. M/s Archana Enterprises has a current account with the State Bank of India. Their pass book showed a balance of ` 35,200 as on 30th June 2003. Taking into account the following, prepare a bank reconciliation statement to find out the balance as per the cash book.
   (i) Cheque issued to creditors amounting to ` 10,000 not presented for payment.
   (ii) Cheque received for ` 7,000 was sent to the bank for collection, on 29th June. It was collected on 2nd July, 2003.
   (iii) Dividend collected by bank on our behalf ` 500. The intimation of the same was received on 3rd July, 2003.
   (iv) Bank had paid insurance premium of ` 800 on behalf of the company for which there was no entry in the cash book.

(v) Interest on bank balance credited in the pass book ` 300 but it was not recorded in the cash book.

(vi) Bank charges of ` 100 charged by bank, but not recorded in the cash book.

3. From the following details, prepare Vipin's Bank Reconciliation Statement as on 31st March 2003.

(i) Balance as per cash book ` 3,000.

(ii) Cheques issued in March ` 8,000 out of which cheques for ` 3,000 were encashed in March.

(iii) Cheques issued but not presented ` 500.

(iv) Cheques issued but dishonoured ` 700.

(v) Cheques deposited in March ` 3,000 out of which cheques for ` 2,000 were cleared in April and thereafter.

(vi) Cheques deposited but dishonoured ` 500 but dishonour entry not made in cash book.

(vii) Dividends collected by the bank ` 800 not entered in cash book.

(viii) Bank charges ` 10 not entered in cash book.

(ix) Direct deposit by a customer ` 250 not entered in cash book.

(x) Interest credited by the bank ` 150 not entered in cash book.

(xi) Direct payment for LIP ` 250 not entered in cash book.

4. The following are the necessary extracts from the Cash Book and the Pass Book. You are required to prepare a Bank Reconciliation Statement as on 31st December, 2012.

Dr. **Cash Book (Bank Column)** **Cr.**

Date	Particulars	`	Date	Particulars	`
2012			2012		
Dec. 1	To Balance b/d	400	Dec. 20	By Sharmila's A/c	65
5	To Sharda's A/c	100	24	By Urmila's A/c	150
10	To Smita's A/c	20	26	By Pramila's A/c	75
16	To Shila's A/c	125	31	By Balance c/d	460
20	To Sunita's A/c	75			
		750			**750**

Dr. **Bank Pass Book** **Cr.**

Date	Particulars	`	Date	Particulars	`
2012			2012		
Dec. 25	To Sharmila's A/c	65	Dec. 1	By Balance b/d	400
27	To Urmila's A/c	125	9	By Sharda's A/c	100
29	To Ramila's A/c	100	16	By Smita's A/c	50
31	To Balance c/d	270	25	By Interest	10
		560			**560**

5. Set out below are extracted from cash book (Bank columns only) and bank pass book of Babulnath. Prepare a bank reconciliation statement as on 15th January 2012.

Dr. **Cash Book (Bank Column)** **Cr.**

Date	Particulars	`	Date	Particulars	`
2012			2012		
Jan. 1	To Balance b/d	1,132	Jan. 2	By Wages A/c	850
5	To K. Kamdar's A/c	900	6	By Investment A/c	1,000
8	To Sales A/c	609	8	By Purchase A/c	306
10	To Rent A/c	56	9	By Furniture A/c	160
12	To Ganpat's A/c	1,252	10	By Bapat's A/c	210
13	To Raman's A/c	888	10	By Drawings A/c	80
15	To Balance c/d	401	14	By Fakir's A/c	1,822
			15	By Mustafa's A/c	810
		5,238			**5,238**

Dr. **Pass Book** **Cr.**

Date	Particulars	`	Date	Particulars	`
2012			2012		
Jan. 2	To Wages A/c	850	Jan. 1	By Balance	1,132
6	To Investment A/c	1,000	6	By K. Kamdar's A/c	900
7	To Purchase A/c	306	8	By Sales A/c	609
9	To Furniture A/c	160	10	By Rent A/c	56
10	To Self (Drawings) A/c	80	14	By J. Jamdar's A/c	200
13	To Bills Payable A/c	100			
15	To Balance c/d	401			
		2,897			**2,897**

6. From the entries of the Cash Book (Bank Column) and the corresponding Bank pass book of Mr. Reddy, you are asked to prepare a Bank Reconciliation Statement as on 31st January, 2013.

Dr. **Cash Book (Bank Column)** **Cr.**

Date	Particulars	`	Date	Particulars	`
2013			2013		
Jan. 1	To Balance b/d	2150	Jan. 10	By Shakti & Co.'s A/c	1,400
6	To Bills Receivable A/c	325	12	By Salaries A/c	300
16	To Sales A/c	610	18	By Drawings A/c	125
22	To R. Ramchandra's A/c	135	29	By Joshi Bros' A/c	210
30	To Naresh Bros' A/c	250	29	By Wages A/c	500
31	To Interest A/c	58	31	By N. Narayan's A/c	320
31	To G. Ganesh's A/c	156	31	By P.Piyush's A/c	175
			31	By Balance c/d	654
		3,684			**3,684**

Dr. **Bank Pass Book** **Cr.**

Date	Particulars	`	Date	Particulars	`
2013			2013		
Feb. 2	To Joshi Bros' A/c	210	Feb. 1	By Balance b/d	1,400
2	To Commission A/c	1	2	By Naresh Bros. A/c	300
3	To N. Narayan's A/c	320	3	By G. Ganesh's A/c	125
3	To P. Piyush's A/c	175	3	By Ramchandra's A/c	210
3	To Commission A/c	1	8	By Cash A/c	500
8	To S.Sirish's A/c	300	10	By M. Manoj's A/c	320
10	To Wages A/c	300	12	By T. Tarawala's A/c	175

7. The following errors were traced while preparing the Final accounts of a firm for the year ending 31st December, 2012. The entries are to be rectified before the books are closed.
   (a) ` 3000 purchase of machinery has been entered in the purchase book.
   (b) Goods worth ` 838 sold to Mr. K on credit is recorded as purchase of ` 983 in Purchase book
   (c) The monthly total of Purchase book for December 1983 has been overcast by ` 250.
   (d) Repairing charges of ` 180 paid for repairing a machine have been debited to the Machinery Account.
   (e) ` 400/- paid to the owner of the shop Shri B for rent has been debited to his personal account.
   (f) The balance of ` 300 of the salaries account has been shown as debit balance.
   (g) Goods worth ` 550 at cost price were distributed as free samples but no entry is made in the books.
   (h) ` 220 received from Mr. A which were written off last year as bad debts were received in cash which have been credited to his personal account.
   (i) ` 20 received in cash from Mr. P is entered in the discount column of cash book through an error.
8. Correct the following errors found in the books of Mr. Dutt. The trial balance was out by ` 493/- excess credit the difference has been posted to Suspense Account.
   (a) An amount of ` 100 was received from Dhiraj on 31st December, 2012 but had been entered in the cash book on 3rd Jan, 2013.
   (b) The total of Return inward book for December had been cast ` 100 short.
   (c) The purchase of an office table costing ` 300/- had been passed through the purchase book.
   (d) ` 375 paid for the wages to workmen for making showcases had been charged to wages account.
   (e) A purchase of ` 67 had been posted to the creditors account as ` 60/-.
   (f) A cheque for ` 200/- received from P.C. Joshi had been dishonoured and was passed to the debit of allowances account.
   (g) ` 1000 paid for the purchase of a motor cycle for Mr. Dutt's personally use had been charged to miscellaneous expenses account.

(h) Goods amounting to ` 100 had been returned by the customers and were taken to stock, but no entry in respect thereof was made into the books.

(i) A sale of ` 200/- to Sanghvi & Co. was wrongly credited to their account.

EXERCISE

Q.1. Name different classes of errors?

Ans: (i) Book-keeping errors (ii) Trial balance errors.

Q.2. Define book-keeping errors?

Ans: Errors which are committed in the books of original entry or ledgers are called book-keeping errors.

Q.3. Name different classes of book-keeping errors?

Ans: (i) Errors of omission (ii) Errors of commission

Q.4. Define errors of omission?

Ans: The errors resulting from the complete failure of entry of transaction in the books are called errors of omission.

Q.5. Name different classes of errors of omission.

Ans: (i) Complete errors (ii) Partial errors.

Q.6. What do you mean by complete errors and gives its two examples?

Ans: When any particular transaction has not at all been entered in the book of original entry, it is known as complete errors. Examples: (i) Cash received from Ali was not recorded in cash book. (ii) Goods sold to Shahid were not recorded in cash book.

Q.7. What do you men by partial errors and give its two examples?

Ans: If a transaction has been recorded in a book of original entry but has not been posted in ledger account, it is called partial error. Examples: (i) Cash received from Ali was not recorded in cash book. (ii) Goods sold to Shahid were not recorded debited to his account.

Q.8. Define error of commission.

Ans: Error which occurs when a transaction is wholly or partially incorrectly recorded in the books of account are called errors of commission.

Q.9. What are different classes of errors of commission?

Ans: (i) Errors of principle, (ii) Compensating errors, (iii) Errors of posting and (iv) Errors of casting.

Q.10. Define compensating errors.

Ans: Compensating errors means errors which are cancelled by other errors of same amount in the same account or error of same amount on the opposite side. These errors are of a neturalizing nature.

Q.11. Define error of posting.

Ans: If a transaction has been recorded in the book of original entry but has been posted wrongly in the ledger account, it is known as error of posting.

Q.12. Define errors of casting and give its two examples.

Ans: The errors which may occur due to shortcasting or excess casting in any book of original entry or in the ledger account. Examples: (i) Sales day book was undercast, (ii) Purchases day book was overcast.

Q.13. What do you know about the "Trial balance errors"?

Ans: Errors which are made in the preparation of Trial balance are called trial balance errors.

Q.14. What is suspense account?

Ans: A ledger account in which entries are made on a temporary basis when the correct account cannot be immediately identified is called suspense account.

Q.15. Give any three examples of trial balance errors.

Ans: (i) Transfer or balance to the wrong column of the trial balance, (ii) Omission of balance from trial balance and (iii) Wrong casting of trial balance.

Q.16. Give any two examples of errors of principle.

Ans: (i) Incorrect application of capital and revenue expenditures, (ii) Wrong estimation of depreciation etc.

Q.17. Pass the rectifying entry, sale of old furniture has been credited to sales account of ` 200.

Ans: Sales Account	Dr.	200	
To Furniture Account			200

Q.18. What rectifying entry will be passed, if sales book was undercast by ` 300?

Ans: Suspense Account	Dr.	300	
To Sales Account			300

Q.19. Name different stages available for rectifying errors in account.

Ans: (i) Before the preparation of trial balance, (ii) After the preparation of trial balance but before the preparation of final accounts, (iii) After the preparation of final accounts.

Q.20. Write down the procedure for correcting errors?

Ans: There are three questions which must be answered before an error can be corrected. They are: (i) What should happened, and (ii) What has happened? (iii) What action will correct the error.

Q.21. Differentiate between errors of omission and errors of commission.

Ans: Errors of omission Errors of commission

Errors of omission	Errors of commission
1. They represent absolute omission.	1. They represent incorrect recording
2. They have no effect on agreement balance.	2. They may effect agreement of trial of trial balance.

Q.22. Give any four types of errors which do not affect the trial balance agreement?

Ans: (1) Errors of principle, (2) Compensating errors, (3) Wrong posting in the same head of account, and (4) Errors of complete omission.

Q.23. Write any two examples of errors which affect agreement of Trial balance?

Ans: (1) Partial omission, and (2) Posting to wrong side of ledger.

Q.24. Differentiate between errors of posting and errors of casting.

Ans:

Errors of posting	**Errors of casting**
1. They represent wrong posting.	1. They represent wrong casting.
2. They involved transferring of transactions form Journal to ledger.	2. They normally consist on wrong casting of books of original entry or ledger's account.

Q.25. What rectifying entry will be passed, if sales book was overcast by ` 1,500?

Ans:

Sales A/c	Dr.	` 1,500	
To Suspense A/c			` 1,500

(Being casting error in sales book rectified)

Q.26. What rectifying entry will be passed, if purchases day book was overcast?

Ans:

Suspense A/c	Dr.		
To Purchases A/c			

(Being casting errors in purchases book rectified)

Q.27. What rectifying entry will be assed ` 2,000 if freight paid on machinery was charged to freight A/c.

Ans:

Machinery A/c	Dr.	2000	
To Freight A/c			2000

(Being error in freight recording rectified).

6 CHAPTER

Capital and Revenue

INTRODUCTION

Accounting is the recording and reporting of business transactions. Business transactions involve activities of actual business (selling goods or services), investment (purchasing assets) and financing (raising money for investment). In accounting, business activities give rise to revenue income and revenue expenditure; investment activities give rise to capital expenditure; financing activities give rise to capital receipts, P & L A/c is a summary of revenue income and revenue expenses, Balance Sheet is summary of capital receipts and capital expenditure.

Expenditure is usually of two types:

1. Capital Expenditure
2. Revenue Expenditure

1. Capital Expenditure: Capital expenditure consists of expenditure, the benefit of which is not fully enjoyed in one accounting period but spread over several accounting periods. It includes assets acquired for the purpose of earning income or increasing the earning capacity of the business or effecting economy in the operation of an asset. These are not meant for sale. Expenditure incurred for improving assets and extending an existing asset is also capital expenditure.

Definition: Eric Kohler has defined capital expenditure as "an expenditure intended to benefit future periods; an addition to fixed assets. The term is generally restricted to expenditures that add fixed asset units or that has the effect of increasing the capacity, efficiency, life span or economy of operation of an existing asset."

Examples:

(a) Interest on capital paid during the period of construction of company.

(b) Expenditure in connection with or incidental to the purchase or installation of an asset

(c) Acquisition of new assets.

(d) Expenditure incurred for putting the old asset purchased into working condition.

(e) Additions and extensions to existing assets.

(f) Betterment of fixed assets or improvement of an asset to produce more to improve its earning capacity or to reduce its operating expenses or to increase the life of asset.

2. Revenue Expenditure: Revenue expenditure consists of expenditure incurred in one period of the accounting, the full benefit of which is enjoyed in that period only. This does not increase the earning capacity of the business but it is incurred in order to maintain the existing earning capacity of the business. It includes all expenses which arise in normal course of business. The benefit of such expenditure is for a short period, say, one year only and it is not to be carried forward to the next year. The expenditure is of a recurring nature, *i.e.*, arises again and again.

Definition: Eric Kohler has defined revenue expenditure as "an expenditure charged against operation: a term used to contrast with capital expenditure."

Examples:

(a) Purchase of raw materials for conversion into finished goods.

(b) Selling and distribution expenses incurred for sale of finished goods, *e.g.*, sales office expenses, delivery expenses, advertisement charges, etc.

(c) Establishment expenses like salaries, wages, rent, rates, taxes, insurance and depreciation on office equipment.

(d) Depreciation of plant, machinery and equipment.

(e) Expenses incurred in order to maintain the existing fixed assets in an efficient and workable state such as repairs to building, repairs to plant, whitewashing and painting of building.

Difference between Capital and Revenue Expenditures

Capital Expenditures	Revenue Expenditures
1. Its effect is long term, *i.e.*, it is not exhausted within the current account year. Its benefit is enjoyed in future year or years also. In a word, its effect reduces gradually.	1. Its effect is temporary, *i.e.*, it is exhausted within the current accounting year.
2. An asset is acquired or the value of an asset is increased as a result of this expenditure.	2. Neither an asset is acquired nor is the value of an asset increased.
3. It does not occur again and again – it is non-recurring and irregular.	3. It occurs repeatedly. It is recurring and regular. recurring and irregular.
4. Generally, it has physical existence, *i.e.*, it can be seen with eyes.	4. It has no physical existence, *i.e.*, it cannot be seen with eyes.
5. This expenditure improves the position of the Concern.	5. This expenditure helps to maintain the position of the concern.
6. A portion of this expenditure is shown in the Trading and Profit & Loss A/c or income and expenditure account as depreciation.	6. The whole amount of this expenditure is shown in Trading and Profit & Loss A/c or income and expense account. But deferred revenue expenditures and prepaid expenses are not shown.
7. It pertains to investing activity	7. It pertains to business activity.
8. It does not reduce the revenue of the concern Purchase of fixed assets does not affect revenue.	8. It reduces revenue. Payment of salaries to employees decreases revenue.

Deferred Revenue Expenditure: Deferred revenue expenditure is a revenue expenditure which has been incurred during one accounting year which is applicable either wholly or in part to further accounting years.

Definition: According to Prof. A.W. Johnson, "Deferred revenue expenditure includes those non-recurring expenses, which are expected to be of financial nature, distributed to several accounting periods of indeterminate total length. These are of revenue nature but are deferred or postponed. It is of quasi-capital nature."

In simple words, we can say that Deferred Revenue Expenses are those expenses, the benefit of which may be extended to a number of years, say, 3 to 5 years. It is basically expenditure while forming company. The benefit of this will be derived in the future years also. Any expenditures relating to capital (shares, debentures, securities) is called deferred revenue expenditure. launching of new project (Advertisement Expenditure).

(a) Expenditure for the issue or raising loan or capital or debentures.

(b) Expenditure for the formation or registration of company.

(c) Preliminary expenditure.

Illustration 1

State with reasons whether the following are capital, revenue or deferred revenue expenses:

(a) Payment for purchase of goods.

(b) Payment for purchase of stationery.

(c) Payment for purchase of a car.

(d) Payment for heavy inaugural expenses.

(e) Payment of salaries.

(f) Wages for erection of machinery.

Solution

(a) It is a Revenue expenditure. It doesn’t result in acquisition of any fixed asset and it is recurring in nature.

(b) It is a Revenue expenditure. It doesn’t result in acquisition of any fixed asset and it is recurring in nature.

(c) It is a Capital expenditure.It brings into existence of new asset and it is non-recurring in nature.

(d) It is basically Revenue in nature, even though it is heavy. It doesn’t result in existence of any assets.

(e) It is a Revenue expenditure. It doesn’t result in acquisition of any fixed asset and it is recurring in nature.

(f) It is a Capital expenditure as it increases the cost of new asset.

Illustration 2

State with reasons whether the following are capital, revenue or deferred revenue expenses:

(a) Expenditure incurred on overhauling of new machinery.

Ans: It is a capital expenditure as it increases the efficiency of the asset and life.

(b) Tax paid.

Ans: It is revenue expenditure, because the benefit of such taxes is exhausted in one year and it is recurring in nature.

(c) Cost of construction of building.

Ans: It is a capital expenditure, because it brings into existence of new asset.

(d) A petrol driven engine of passenger bus was replaced by diesel engine.

Ans: It is a capital expenditure as it increases the efficiency of the passenger bus and it is nonrecurring in nature.

(e) Cost of improving sitting capacity of cinema hall.

Ans: It is a capital expenditure as it would result in increased earning

(f) Heavy amount spent on legal suit.

Ans: It is a revenue expenditure even though it is heavy. It is recurring in nature.

(g) Expenditure for training to employees.

Ans: It is a deferred revenue expenditure as it's benefit is available for subsequent year.

(h) Expenditure on research project, which ultimately results in success.

Ans: It is a deferred revenue expenditure as it's benefit is available for subsequent year.

Problems for Self-practice

1. State whether the following expenditure is Capital, Revenue or Deferred revenue expenditure Give reasons:
   (a) Legal expenses incurred in connection with issue of Equity Shares of the company.
   (b) Cost of replacement of defective part of the machinery.
   (c) Expenditure incurred in preparing a project report.
   (d) Expenditure for training employees for better running of the machinery.
   (e) Purchase of machinery for sale.
   (f) Daily wages paid to an office peon.
2. State, which of the following expenses are Capital, Revenue and Deferred revenue. Explain with reasons:
   (a) Professional fees paid in connection with acquisition of leasehold premises.
   (b) Cost of Registration and documentation of a new form company.
   (c) Compensation paid to a retrenched employee for loss of employment.
   (d) Expenditure incurred on purchase of cloth for uniform for employees.
   (e) Payment of Import duty on purchases of new materials.

3 Classify the following expenses between Capital and Revenue, starting reasons in each case:
   (a) Petrol driven engine of a passenger bus was replaced by a diesel engine.
   (b) Expenses incurred on research for a particular product, which ultimately did not result in success.
   (c) Expenses incurred for shifting the work to new premises having better facilities.
   (d) Cost of repairing the factory shed.

CAPITAL RECEIPTS AND REVENUE RECEPTS

Capital Receipts: Capital receipts are those receipts which are non-recurring in nature and they are not arising out of normal activity of business. They are un-usual in nature. For example:

1. Amount received on issue of shares and debentures.
2. Loan received
3. Proceeds from sale of fixed assets.
4. Premium receipts on issue of shares.

Generally Capital receipts are recorded in balance sheet.

Revenue Receipts: Revenue receipts are those receipts, which are received on the ordinary course of business. They are recurring in nature. They are arising through the normal business activity. For e.g.

1. Commission or discount receipt.
2. Interest's or dividend on investment.
3. Transfer fees.
4. Profit on sale of asset or investment.

Generally Revenue receipts are credited to profit and loss account.

Capital Payment	Revenue Payment
1. Capital receipt pertains to financing activity.	1. Revenue receipts pertains to business activity.
2. Examples are capital from owner, loans from bank, etc.	2. Examples are revenue receipts from sale of goods, fees, interest, dividend, royalty.
3. Capital receipts are shown as liability in balance sheet.	3. Revenue receipt pertaining to current year is shown as income in P & L A/c. Revenue receipt pertaining to future period is shown as liability (advance income) in balance sheet.
4. Capital receipts may be returned back.	4. Revenue receipt cannot be returned/refunded.
5. Capital receipts is non-recurring in nature.	5. Revenue receipt is recurring in nature
6. Capital receipts increases funds available for investment, but may reduce profits as interest is to be paid on loans obtained.	6. Revenue receipts increases profits and funds.

Capital Payment and Revenue Payment

Capital Payment: These are the payment which results in reduction in long term liabilities of the business. They are generally non-recurring in nature. For example:

1. Repayment of capital
2. Redemption and buyback of shares and debentures
3. Repayment of bank loan or term loan

Revenue Payment: These are the payment which results in reduction in short term liabilities of the business and they are generally recurring in nature. For example:

1. Payment of outstanding liabilities
2. Payment to creditors
3. Proposed dividend paid

CAPITAL AND REVENUE PROFITS

Definition and Explanation

Capital profit means a profit made on the sale of a fixed asset or profit earned on raising monies for the business. For example, a building purchased for ` 20,000 is sold for ` 25,000. The profit ` 5,000, thus, made is a capital profit. Revenue profit, on the other hand, is a profit made by the business, *e.g.*, profit on the sale of goods, interest from investments, commission earned etc.

Whenever capital profit is made, it should either be transferred to the capital account of the proprietor or credited to capital reserve account which would appear as a liability on the balance sheet.

But capital profits, should in no case be transferred to profit and loss account because it is non-trading profit. Revenue profits, on the other hand, should be transferred to profit and loss account because they arise out of regular trading operation.

CAPITAL AND REVENUE LOSSES

Definition and Explanation

Capital loss means a loss made on the sale of a fixed asset or a loss incurred in connection with the raising of money for business. Capital loss may be shown as an asset in the balance sheet. But as this asset is of fictitious nature, it would advisable to write off it.

Revenue loss, on the other hand, is the loss incurred in trading operations such as loss on the sale of goods. Revenue losses are charged to profit and loss account of the year in which they occur.

CAPITALIZED OR DEFERRED REVENUE EXPENDITURES

Where a certain revenue expenditure incurred is of such a nature that its benefit is likely to be spread over a certain number of years, or where it is of non-recurring and special nature and large in amount, in such circumstances, instead of debiting the entire amount to the profit and loss account of the year in which it has been incurred, it may be spread over a number of years, a proportionate amount as Revenue Expenditure being charged to each year's Profit & Loss Account. The remaining portion of the expenditure is carried forward and is known as Capital Expenditure or Deferred Revenue Expenditure and is shown as an asset in the Balance Sheet. Items such as preliminary expenses, cost of issue of debentures are examples that may be classified under this head.

Exceptions to General Rules

There are certain expenses which are usually of revenue in nature but under certain circumstances they become capital expenditures. The following are the examples of expenses which are usually revenue but under certain circumstances become capital.

Legal Charges: These are, as a rule, revenue charges, but legal charges incurred in connection with the purchase of a fixed asset are capital expenditures as they form an additional cost of the asset acquired.

Wages: Wages are ordinary revenue expenditure. But in a manufacturing business where the firm's own men are employed in making of fixed asset, the wages paid for such purpose would be capitalized. For example, if the firm's own men are employed in making extension to the factory building or in erection of plant or manufacturing tools for own requirements, the wages and salaries paid to the persons are not revenue but capital expenditures.

Brokerage and Stamp Duty: Normally, these are revenue expenditures, but brokerage paid on acquisition of a property and stamp duty involved thereon can be capitalized. Freight and Carriage: This is revenue charge, but freight and carriage paid on newly acquired plant or fixed assets are capital expenditures.

Advertising: Ordinarily, amount expended on advertising is revenue charge but the cost of special advertising undertaken for the purpose of introducing a new line of goods may be capitalized.

Development Expenses: In concern like collieries, mines, tea, rubber etc., all expenses incurred during the period of development are treated as capital.

Preliminary Expenses: These are the expenses incurred in connection with the formation of a public company. These expenses although are revenue in nature but are allowed to be capitalized and can be shown as an asset in the balance sheet.

Illustration 3

1. State with reasons whether the following items relating to sugar mill company are capital or revenue:
   (a) Motor truck costing ` 15,000 and standing in the books at ` 7,250 was sold for ` 12,000.
   Ans: Amount equivalent to book value, *i.e.*, ` 7,250 is treated as capital receipt and ` 4,750 will be treated as Revenue profit.
   (b) Building costing ` 2,00,000 and standing in books for ` 1,30,000 was sold for ` 2,30,000.
   Ans: Out of this ` 2,30,000, amount equivalent to book value, *i.e.*, ` 1,30,000 will be treated as Capital receipt and amount in excess of original cost, *i.e.*, ` 30,000 will be treated as capital profit and the balance amount ` 70,000 will be considered as Revenue profit.
   (c) ` 20,000 received from issue of shares, the expenses of issue being ` 2,500.
   Ans: ` 20,000 will be considered as Capital receipt and expenses on such issues, *i.e.*, ` 2,500 ill be considered as Deferred Revenue expenditures.
   (d) ` 50,000 invested in Government Loan.
   Ans: It is a capital payment as it is an asset, but doesn't chargeable to depreciation.
   (e) Subsidy received from government.
   Ans: It is a revenue receipt as it is recurring in nature.

PROBLEMS

1. A newly set up manufacturing concern incurred various types of expenses during the construction period.
   (a) Travelling expenses of Directors for a trip abroad for purchasing Capital goods.
   (b) Salaries and Wages paid to technical staff for erection of machinery.
   (c) Salaries and Wages paid to non-technical staff, during erection of machinery.
   (d) Miscellaneous expenses such as rent, stationery and printing, postage and telegram conveyance etc.
   (e) The factory is still under construction. The Company desires to capitalise the above expenses.

   State with reasons whether the expenditure is properly chargeable to Capital. Show how you would deal with the above expenditure in final accounts of the Company.
2. Classify the following between Capital expenditure and Revenue expenditure giving brief reasons in each case.
   (a) Cost of ` 30,000 for dismantling, removing and reinstalling plant by a sugar milk incurred in connection with the removal of works to a more suitable locality.
   (b) A sum of ` 10,000 spent for alteration of existing plant incorporating thereby new devices, which could effect substantial reduction in power consumption.
   (c) Imported goods worth ` 25,000 confiscated by custom authority for non-disclosure of material facts.
   (d) A petrol driven engine of a passenger bus was replaced by a diesel engine.
   (e) Cost of repainting the factory shed.
   (f) Cost of transportation ` 5,000 in connection with a new acquired machine.

(g) Heavy amount spent in a legal suit.

(h) ` 1,000 spent on replacement of defective parts of an old plant.

3. State with reasons whether the following are capital, revenue or deferred revenue expenses.
   (a) Payment for purchase of goods.
   (b) Payment for purchase of Stationery.
   (c) Payment for purchase of a car.
   (d) Payment for heavy inaugural expenses
   (e) Partial refund of capital to a partner
   (f) Payment of loan taken earlier.
   (g) Payment of salaries
   (h) Wages for erection of machinery.
4. State which of the following expenses are Capital, Revenue and Deferred revenue. Explain with reasons.
   (a) Expenditure incurred on overhauling machinery.
   (b) Taxes paid
   (c) Wages paid to the workers for erection of new machinery.
   (d) Cost of goodwill
   (e) Heavy expenditure incurred on advertisements.
   (f) Cost of construction of a building.
   (g) Machinery costing ` 10,000 (WDV 3,000) sold for ` 4,000
   (h) Purchased machinery for ` 15,000
5. Determine whether the following expenditure is Capital or Revenue expenditure:
   (a) Repairs of building
   (b) Legal Expenses incurred in connection with issue of share capital.
   (c) Amount realised from sale of old machinery.
   (d) Amount brought by the Proprietor as capital.
   (e) Building costing ` 20,000 sold for ` 35,000 (WDV ` 12,000).
6. State, which of the following expenses are Capital, Revenue and Deferred revenue. Explain with reasons:
   (a) Stock of ` 25,000 was destroyed by fire of which ` 15,000 was received from the Insurance Company.
   (b) The Concern spent ` 1,00,000 on heavy advertisement campaign to introduce a new product in the market.
   (c) Cost of dismantling a plant from particular locality and reinstalling the same in another locality.
   (d) Cost of transporting newly produced furniture.
   (e) Amount spent by factory in overhauling its plant, which has enhanced the life of the plant by five years.
   (f) Travelling expenses for a trip abroad for purchase of Capital goods.
   (g) Amount spent on replacement of defective parts of old plants.
   (h) Cost of goodwill purchased.

EXERCISE

A. Match the Column

Group 'X'	Group 'Y'
1. Expenditure on training	(a) Capital
2. Expenditure on project report	(b) Capital
3. Wages for construction of building	(c) Capital
4. Custom duty on import of machine	(d) Revenue
5. Invested in Government loans	(e) Capital
	(e) Deferred revenue expenditure

Ans: 1. (d), 2. (e), 3. (c), 4. (a), 5. (c).

Group 'X'	Group 'Y'
1. Repayment of loan.	(a) Capital expenditure
2. Fees for acquisition of lease	(b) Capital receipt
3. Term loan for bank	(c) Revenue expenditure
4. Renewal of licencer	(d) Revenue expenditure
5. Legal expenses on collection form debtors	(e) Capital expenditure
	(f) Capital loss

Ans: 1. (e), 2. (a), 3. (b), 4. (c), 5. (d).

B. Fill in the blanks

1. _______ expenditure is recurring.
2. _______ expenditure in non-recurring.
3. _______ expenditure is shown in Balance Sheet on asset side.
4. _______ expenditure is shown in Profit & Loss account.
5. _______ receipts are shown in income in Profit & Loss account.
6. _______ receipts are shown in Balance Sheet.
7. _______ is expenditure on asset held for generation of interest/dividend.
8. _______ expenditure does not give any further benefits.
9. Wages paid for installation for machinery is a _______ expenditure.
10. Carriage on purchase of furniture is _______ expenditure.
11. Repairs of machinery is _______ expenditures.
12. Payment of penalty is a _______ expenditure.
13. Documentation charges regarding purchase of a building is a _______ expenditure.
14. Depreciation is _______ in nature.
15. Advertising is _______ expenditure.
16. Demolition cost of old building is _____ ______ ______.
17. Overhauling of machinery is a _______ receipt.
18. Amount received on scale of goods is a ______ receipt.
19. Commission received is a _______ receipt.

20. Heavy legal expenses are _____ _____ _____.
21. Bad debt recovery is a _______ receipt.

[**Ans:** 1. Revenue, 2. Capital, 3. Capital, 4. Revenue, 5. Revenue, 6. Capital, 7. Investment, 8. Revenue, 9. Capital, 10. capital, 11. revenue, 12. revenue, 13. capital, 14. revenue, 15. revenue, 16. deferred revenue expenditure, 17. revenue, 18. revenue, 19. revenue, 20. deferred revenue expenses, 21. Revenue.]

C. True or False

1. Pre-advance expenses are revenue expenses.
2. Heavy expenses incurred on advertising at the time of introducing a new produce is a deferred revenue expenditure.
3. Expenses incurred to keep the machine in working condition is a capital expenses.
4. An expenditure intended to benefit the current period is a revenue expenditure.
5. Amount written off from cost of the fixed asset is capital expenditure.
6. Deferred revenue expenditure is current years revenue expenditure to be paid in the last year.
7. Expenditure, which results in acquisition of a permanent asset, is a capital expenditure.
8. Wages paid for erection of machinery are debited to Profit & Loss Account.
9. Amount paid for acquiring goodwill is deferred revenue expenditure.
10. Overhaul expenses of a second half machinery purchased are revenue expenditure.
11. Major repairs charges include replacement of certain worn out parts incurred before using a second hand car purchased recently is a capital expenditure.
12. The gain from sale of capital assets need not be added to revenue to ascertain the net profit of a business.
13. Capital work in progress is a capital expenditure.
14. Capital expenditure is non-recurring in nature.
15. Revenue expenditure is recurring in nature.
16. Capital receipt is recurring in nature.
17. Revenue earned in the current year but not received is an asset.
18. If revenue expenditure is shown as capital expenditure, Profit & Loss Account shows more profit.
19. If capital expenditure is shown as revenue expenditure, Balance sheet shows less assets.
20. Expenses incurred to bring the second hand machine in working condition is a capital expenditure.
21. Expenditure on carriage of machinery is a capital expenditure.
22. Expenditure on documentation regarding purchase of building is a revenue expenditure.
23. Wages paid for installation of machinery are debited to Profit & Loss Account.
24. Heavy expenditure on advertising at the time of opening of a new branch is a deferred revenue expenditure.
25. Expenditure intended to benefit current period is a revenue expenditure.
26. Amount paid for acquisition of patents is a capital expenditure.

27. An error of principle results in incorrect allocation of expenditure between capital and receipt.
28. Wages paid to workers to produce a tool is a capital expenditure.
29. Amount paid for replacement of worn out part of machine is a capital expenditure.
30. Amount spent on white washing of factory building done after 6 months is a capital expenditure.
31. Temporary shed constructed to store material at project site is a capital expenditure.
32. Expenditure incurred on renovation of a shop, which increased the capacity, is a capital expenditure.
33. Legal expenses incurred for abuse of a trademark is a capital expenditure.
34. Fictitious assets are tangible.
35. Revenue expenditure increases the profit earning capacity of an organisation.
36. Repairs of a furniture is a capital expenditure.
37. Expenses for registration of the purchase of the building is a revenue expenditure.
38. Expenses on extension of a gallery to the building is a revenue expenditure.
39. Expenses incurred for purchase of livestock is a capital expenditure.
40. New tyres to replace old tyres of a car is capital expenditure.

[**Ans:** 1. False, 2. True, 3. False, 4. True, 5. False, 6. False, 7. True 8. False, 9. False, 10. False, 11. True, 12. True, 13. True, 14. True, 15. True, 16. False, 17. True, 18. True, 19. True, 20. True, 21. True, 22. False, 23. False, 24. True, 25. True, 26. True, 27. True, 28. True, 29. False, 30. False, 31. True, 32. True 33. False, 34. False, 35. False, 36. False, 37. False, 38. False, 39. True 40. False.]

Select the Right Answer

1. Legal expenses incurred in connection with issue of capital.
   (a) Revenue expenditure (b) Capital expenditure
   (c) Deferred revenue expenditure (d) None of the above
2. Cost of replacement of a defective part of the machinery.
   (a) Revenue expenditure (b) Capital expenditure
   (c) Deferred revenue expenditure (d) None of the above
3. Expenditure incurred in preparing a project report.
   (a) Revenue expenditure (b) Capital expenditure
   (c) Deferred revenue expenditure (d) None of the above
4. Expenditure for training employees for better running of machinery.
   (a) Revenue expenditure (b) Capital expenditure
   (c) Deferred revenue expenditure (d) None of the above
5. Amount spent on uniform of workers.
   (a) Revenue expenditure (b) Capital expenditure
   (c) Deferred revenue expenditure (d) None of the above

6. White-washing of the factory of building.
   (a) Revenue expenditure (b) Capital expenditure
   (c) Deferred revenue expenditure (d) None of the above
7. Import duty on raw material purchased.
   (a) Revenue expenditure (b) Capital expenditure
   (c) Deferred revenue expenditure (d) None of the above
8. Fees paid for renewal of licence for factory.
   (a) Revenue expenditure (b) Capital expenditure
   (c) Deferred revenue expenditure (d) None of the above
9. The freight and cartage on the new machine amounted to ` 300 and erection charges ` 550.
   (a) Revenue expenditure (b) Capital expenditure
   (c) Deferred revenue expenditure (d) None of the above
10. ` 5,150 spent on repairs before using a second-hand car purchased recently to put in usable condition.
   (a) Revenue expenditure (b) Capital expenditure
   (c) Deferred revenue expenditure (d) None of the above
11. Gave ` 1 lakh as custom duty on the machinery imported.
   (a) Revenue expenditure (b) Capital expenditure
   (c) Deferred revenue expenditure (d) None of the above
12. Invested ` 2 lakhs on the purchase of ` 2,000 equity shares of ` 100 each of a subsidiary company.
   (a) Revenue expenditure (b) Capital expenditure
   (c) Deferred revenue expenditure (d) None of the above
13. Placed a deposit of ` 3 lakhs with the bankers as margin money for obtaining guarantee of ` 10 lakhs in favour of Bharat Petroleum Limited.
   (a) Revenue expenditure (b) Capital expenditure
   (c) Deferred revenue expenditure (d) None of the above
14. Furniture worth ` 19,500 destroyed by fire, which was not insured.
   (a) Revenue expenditure (b) Capital expenditure
   (c) Deferred revenue expenditure (d) Capital loss
15. Spent ` 39,600 on research, but subsequently the project was abandoned by the management.
   (a) Revenue expenditure (b) Capital expenditure
   (c) Deferred revenue expenditure (d) None of the above
16. ` 60,000 spent on construction of railway siding.
   (a) Revenue expenditure (b) Capital expenditure
   (c) Deferred revenue expenditure (d) None of the above
17. Expenditure incurred on overhauling machinery.
   (a) Revenue expenditure (b) Capital expenditure
   (c) Deferred revenue expenditure (d) None of the above

18. Cost of goodwill.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) None of the above
19. Purchase of machinery for sale.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) None of the above
20. Amount spent by factory in overhauling its plant which has enhanced the life of the plant by five years.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) None of the above
21. Spent towards additions to machinery in order to double the production, ` 40,000.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) None of the above
22. Incurred for repairs to machinery, necessitated by the negligence of the employees, ` 24,000.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) None of the above
23. ` 12,000 interest has accrued during the year on term loan obtained and utilised for the construction of factory building and purchase of machineries. However, the production has not commenced till the last day of the accounting year.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) None of the above
24. Office rent paid in advance for three years.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) None of the above
25. ` 10,000 were spent on advertising for the introduction of a new product in the market, the benefit of which will be effective during four years.
    (a) Revenue expenditure (c) Deferred revenue expenditure
    (b) Capital expenditure (d) None of the above
26. Visit of sales manager abroad, total cost ` 16,000 for promoting export sales; visit was quite successful.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) None of the above
27. Cost of purchasing copyright from author.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) None of the above
28. Amount received from landlord as compensation for surrender of tenancy rights to the shop of the concern.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) Capital receipt

29. Donation given to Army Central Welfare Fund.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) None of the above
30. Gift received from father of proprietors deposited in bank account of concern.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) Capital receipt
31. Profits before incorporation of the company.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) Capital profit
32. Profit on re-issue of forfeited shares.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) Capital profit
33. Amount received from a sundry debtor.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) Revenue receipt
34. Gratuity and pension paid to employees after retirement.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) None of the above
35. Renewal of Factory License.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) None of the above
36. Expenditure incurred on account of Trade Fair.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) None of the above
37. Preliminary expenses paid ` 12,000.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) None of the above
38. Receipt of commission by a firm a brokers.
    (a) Revenue expenditure (b) Capital expenditure
    (c) Deferred revenue expenditure (d) None of the above
39. (i) Purchased a new motor van ` 17,500 from B. G. Traders Ltd. on credit.
    (ii) Paid cheque ` 740 to Office Furnishing Ltd. being ` 650 for a new office desk and ` 90 for repair of an existing desk.
    (iii) Paid ` 1,420 by cheque for repairs and improvements to premises ` 1,000 of this amount is to be capitalised.
    (iv) Paid an additional ` 2,400 into the business bank account from his private bank account.
    (v) Purchased additional premises for ` 30,000 which was paid by cheque.
    State the total amount of capital expenditure involved in the above transactions
    (a) ` 53,800, (b) ` 49,150,
    (c) ` 50,570, (d) None

40. Petrol expenses of ` 420 paid for the car of one of the partners for an official visit, the car not being an asset of the firm.

    (a) Revenue expenditure
    (b) Capital expenditure
    (c) Deferred revenue expenditure
    (d) None of the above

41. Interest on investment received from UTI.

    (a) Revenue expenditure
    (b) Capital expenditure
    (c) Deferred revenue expenditure
    (d) None of the above

42. A bad debt recovered during the year _______.

    (a) Revenue expenditure
    (b) Capital expenditure
    (c) Deferred revenue expenditure
    (d) None of the above

43. Cost of experimenting a new product which did not result in success.

    (a) Revenue expenditure
    (b) Capital expenditure
    (c) Deferred revenue expenditure
    (d) None of the above

44. Amount embezzled by employee during his employment.

    (a) Revenue expenditure
    (b) Capital expenditure
    (c) Deferred revenue expenditure
    (d) Revenue loss.

45. Development costs in a new mine.

    (a) Revenue expenditure
    (b) Capital expenditure
    (c) Deferred revenue expenditure
    (d) None of the above

46. Amount of ` 5,000 spent as lawyer's fee to defend a suit claiming that the firm's factory site belonged to the plaintiff's land.

    (a) Capital expenditure
    (b) Revenue expenditure
    (c) Deferred revenue expenditure
    (d) None of the above

47. Insurance claim received on account of machinery damaged completely by fire.

    (a) Capital receipt
    (b) Revenue receipt
    (d) Revenue expenditure
    (c) Capital expenditure

48. Amount received from IDBI as a medium term loan for working capital.

    (a) Capital expenditure
    (b) Revenue expenditure
    (c) Capital receipt
    (d) Revenue receipt

49. Revenue from sale of products ordinarily is reported as part of the earning in the period.

    (a) the sale is made
    (b) the cash is collected
    (c) the products are manufactured
    (d) the planning takes place

50. If repair cost is ` 25,000, Whitewash expenses are ` 5,000, cost of extension of building is ` 2,50,000 and cost of improvement in electrical wiring system is ` 19,000; the amount to be expensed is _______.

    (a) ` 2,99,000
    (b) ` 44,000
    (c) ` 30,000
    (d) None

7

CHAPTER

Depreciation, Provisions and Reserves

INTRODUCTION

Every business concern acquires and holds certain fixed assets like Land, Building, Plant, Machinery, Furniture and fixture, Computer etc. for long term in the business. They are brought with the view to use them in the course of the business for a long period of time. Due to the use of the fixed assets, the value declines. Shrinkage in the book value of fixed asset is of permanent and continuing nature. Such permanent and continuing decline in value of fixed asset is called Depreciation.

MEANING OF DEPRECIATION

The word *'depreciation'* is derived from Latin word *'Depretium'* which means *'decline'* or 'reduction' in price or value. Depreciation is concerned with fixed assets only. Fixed assets have long life and loose their value due to the usages. Even if the asset is not put to use, its value goes on reducing due to time span, *i.e.*, efflux. In other words, depreciation means fall in the value of an asset because of usage or with efflux of time or due to obsolescence or accident.

Accordingly, depreciation is the continuous, gradual and permanent reduction in the value of fixed asset brought about by factors like wear and tear, erosion, rot or rust, obsolescence, depletion or exhaustion, passage (efflux) of time, etc.

DEFINITIONS OF DEPRECIATION

Carter defines *"Depreciation is the gradual and permanent decrease in the value of an asset from any cause whatsoever"*.

According to **William Pickles**, *"Depreciation is the permanent and continuing diminution in the quality, quantity or value of an asset"*.

From the above definitions, the following facts can be noted or Important features of depreciation.

1. Depreciation is a loss.
2. It is a reduction in the value of an asset.
3. The decrease in the value of asset is due to its use, caused by wear and tear or any other reason.
4. Such reduction in the value is gradual and continuous except Land. Because land does not have definite economic life.
5. The term depreciation is used only in respect of fixed assets.
6. Depreciation is a charge against profit.
7. Depreciation is different from maintenance.

8. Depreciation is a part of operating cost. Therefore, it is transferred to Profit & Loss Account at the end of financial year.
9. It is a permanent and continuous decrease in the book value of an asset. (Reduction in the value of fixed asset on account of depreciation is not temporary but permanent.)

CAUSES OF DEPRECIATION

1. **Wear and Tear:** Wear and tear refers to loss of utility or usefulness of an asset due to its use. Wear and tear takes place in the case of tangible fixed asset such as machinery, furniture, etc.
2. **Efflux of Time or Passage of Time:** Even if fixed asset is not used, its value declines over a period of time. Thus, depreciation is required to be charged on idle machinery or building.
3. **Obsolescence:** On account of new invention or introduction of new technology, the old or existing asset becomes outdated or useless. Such a loss or reduction is called as obsolescence, *e.g.*, introduction of computers, reduces market value of typewriters.
4. **Exhaustion or Depletion:** Assets may get exhausted or depleted due to its constant use or working, *e.g.*, mines, quarries, oil wells, etc.
5. **Damage:** Damage of assets due to fire, accident, natural calamities like floods, earthquakes, etc. reduces their values.

NEED FOR DEPRECIATION

1. **To Ascertain True Profit or Loss:** Depreciation is an expense and becomes an important element of the cost of production. Though it is not visible like other expenses and never paid to the outside party, yet it is considerable to charge depreciation on fixed assets, as these are used for earning purposes. So, the reduction in the value of fixed assets must be deducted from the income earned in order to calculate the true and real profit or loss of the business.
2. **To Show True Financial Position:** Balance sheet shows the true and fair financial position of the business. So, the fixed assets are required to be shown at their true values. If depreciation is not provided on assets, it amounts overstatement of assets in the Balance Sheet and will not reflect the true financial position of the business. Therefore, it is necessary that depreciation must be deducted from the fixed asset in the Balance Sheet.
3. **To Make Provisions for Replacement of Fixed Assets:** The amount of depreciation charged and debited to profit and loss account every year is not paid as like other expenses. This amount is retained in the business and invested in some securities or in the business. The funds so accumulated is made available to the business for replacement of fixed assets when its life is over or it becomes unproductive.
4. **To Meet the Legal Requirements:** It is necessary to charge depreciation to comply with the provisions of Companies Act and the Income Tax Act.

FACTORS AFFECTING DEPRECIATION OR CONCEPTS IN DEPRECIATION

1. **Cost of the Asset:** The total cost of an asset means the purchase price of an asset plus incidental expenses of the asset such as freight, transport charges, installation charges, wages for erection, fixation charges etc. upto the point the asset is ready for use.

2. **Estimated Scrap Value:** It is the residual value of the asset which can be realised at the end of the effective life of the asset. The asset may become outdated after its estimated life, then it may be sold as scrap.
3. **Estimated Useful Life of Asset:** Life of any fixed asset refers to total period for which a fixed asset can be used. The useful life of the asset may be calculated in terms of years. An asset may still exist physically but may not be capable of producing the same results at a reasonable cost. So, physical life of the asset is not important, rather its useful life is important from accounting point of view.

FORMULA FOR CALCULATION OF DEPRECIATION

1. $$\text{Depreciation p.a.} = \frac{\text{Cost of the Asset} - \text{Estimated Scrap Value}}{\text{Estimated life of the asset}}$$

OR

$$\text{Depreciation p.a.} = \frac{\text{Cost of the Asset} + \text{Installation Charges} - \text{Scrap Value}}{\text{Life of the Asset}}$$

OR

2. $$\text{Depreciation p.a.} = \text{Cost of the Asset} \times \text{Rate of Depreciation}$$

OR

$$\text{Depreciation p.a.} = \text{Book Value/Opening Balance of the Asset} \times \text{Rate of Depreciation}$$

METHODS OF DEPRECIATION

The different methods of depreciation are stated below:

1. Straight Line Method/Fixed Installment Method
2. Written Down Value Method/Reducing Balance Method
3. Annuity Method
4. Depreciation Fund Method
5. Revaluation Method
6. Insurance Policy Method
7. Sum of the Digits Method
8. Machine Hour Rate Method
9. Depletion Method

As per the Syllabus, students are required to study the following two methods of Depreciation. These methods are:

1. Straight Line Method and
2. Written Down Value Method.

1. Straight Line Method: Under this method, the depreciation is usually charged at fixed percentage on the original cost of the Fixed Asset every year.

This method is very simple and easy. Under this method, a fixed percentage of the original value of the asset is written off every year, so as to reduce the asset account to nil or to its scrap value at the end of the estimated life of the asset.

If the charge of depreciation plotted annually on graph paper and the points are joined together, then it will show a straight line. So, this method is called as *"Straight Line Method"*.

As the amount of depreciation per year remains constant, this method is called as *"fixed Installment Method"*.

As the depreciation is charged on original cost every year. This method is also called as *"Original Cost Method"*.

Features

1. The rate of depreciation is fixed as a fixed percentage.
2. Depreciation is charged as a fixed percentage on original cost of the assets.
3. The amount of depreciation is same during the economic life of the asset.

Merits

1. It is the simplest method of charging depreciation.
2. The provision for depreciation is spread equally.
3. It is suitable to leasehold properties and patents.

Demerits

1. If additional asset does not have the same working life; separate calculations are to be made.
2. It does not take in to account effective utilization of asset.

When provision for Depreciation Account is not maintained, *i.e.*, Depreciation is charged or credited to the Asset A/c.

Under this method the amount of depreciation is charged to (debited to) the Depreciation Account and credited to the Asset Account. The Asset Account appears in the Balance Sheet at the value remaining after deducting depreciation. Depreciation Account, being nominal Account, is transferred to Profit and Loss Account at the end of accounting year. The Journal entries under this method are as follows.

1. **For purchase of asset:**

   Asset A/c Dr.

   To Cash/Bank/Party's (Supplier's) A/c

   (Being asset purchased for cash or on credit)

2. **For expenses paid on asset:**

   Asset A/c Dr.

   To Cash/Bank A/c

   (Being expenses paid on asset)

3. **At the end of every accounting year:**

   (a) For providing depreciation:

   Depreciation A/c Dr.

   To Asset A/c

   (Being depreciation charged on asset for the year ___ at ___% p.a. by FIM/RBM)

   (b) For transfer of depreciation to Profit & Loss A/c:

   Profit & Loss A/c Dr.

   To Depreciation A/c

   (Being depreciation for the year ___ transfer to Profit & Loss A/c) Or

   (Being balance in Depreciation A/c transfer to Profit & Loss A/c)

4. For sale of asset:

(a) For sale proceeds of asset:

Cash/Bank/Party's (Purchaser's A/c) Dr.
  To Asset A/c
(Being asset sold for cash or on credit)

(b) For depreciation on asset sold (according to the period of use, *i.e.*, 1st day of accounting year till the date of sale):

Depreciation A/c Dr.
  To Asset A/c
(Being depreciation charged on asset sold for___ period at ___% p.a. by FIM/RBM)

(c) Entry for profit or loss on sale of asset:

Profit or Loss = Selling Price – Book Value of the Asset Sold as on Date of Sale

If profit:

Asset A/c Dr.
  To Profit & Loss A/c
(Being profit on sale of asset transferred to Profit & Loss A/c)

If loss:

Profit & Loss A/c Dr.
  To Asset A/c
(Being loss on sale of asset transferred to Profit & Loss A/c)

PROFORMA LEDGER ACCOUNTS

In the books of ……………

Dr. Asset A/c Cr.

Date	Particulars	Amt.	Date	Particulars	Amt.
	To Balance b/d	XX		By Depreciation A/c (Depreciation charged)	XX
	To Cash/Bank/Party's A/c (Purchase of Asset)	XX		By Cash/Bank/Party's A/c (Sale of Asset)	XX
	To Cash/Bank A/c (Expenses on asset)	XX		By Profit & Loss A/c (Loss on sale of asset)	XX
	To Profit & Loss A/c (Profit on sale of asset)	XX		By Balance c/d	XX
		XX			XX

Dr. **Depreciation A/c** **Cr.**

Date	Particulars	Amt.	Date	Particulars	Amt.
	To Asset A/c (for depreciation)	XX		By Profit & Loss A/c (for transfer)	XX
		XX			XX

Illustration 1

Duryodhan purchased a Motor Truck at a cost of ` 60,000/- on 1st January, 1985. Its useful life is 9 years, at the end of which it is estimated to fetch ` 10,000/-. The incidental expenses for the purchases of the truck amounted to ` 4,000/-. Duryodhan wants to write off depreciation on fixed installment basis.

How much depreciation should be written off every year? Prepare a Motor Truck A/c for the year 1985, 1986, 1987 and 1988.

Solution

In the Books of Duryodhan

Dr. **Motor Truck A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
1/01/85	To Cash A/c (60000 + 4000)		64,000	31/12/85	By Depreciation A/c By Balance c/d		6,000 58,000
			64,000				**64,000**
1/01/86	To Balance b/d		58,000	31/01/86	By Depreciation A/c By Balance c/d		6,000 52,000
			58,000				**58,000**
1/01/87	To Balance b/d		52,000	31/12/87	By Depreciation A/c By Balance c/d		6,000 46,000
			52,000				**52,000**
1/01/88	To Balance b/d		46,000	31/01/88	By Depreciation A/c By Balance c/d		6,000 40,000
			46,000				**46,000**

Dr. **Depreciation A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
31/12/85	To M.T.'s A/c		6,000	31/12/85	By P & L A/c		6,000
			6,000				**6,000**
31/11/86	To M.T.'s A/c		6,000	31/12/86	By P & L A/c		6,000
			6,000	31/12/87	By P & L A/c		**6,000**
31/12/87	To M.T.'s A/c		6,000				6,000
			6,000	31/01/88	By P & L A/c		**6,000**
31/12/88	To M.T.'s A/c		6,000				6,000
			6,000				**6,000**

$$\text{Depreciation p.a.} = \frac{\text{Cost} - \text{S.V}}{\text{Life}}$$

$$= \frac{4000 - 10000}{9}$$

$$= \frac{54000}{9}$$

$$= 6{,}000 \text{ p.a}$$

Illustration 2

A company purchased Machinery worth ` 1,00,000/- on 1st March, 1985. Accounting year of the company closes on 31st March, every year. Company provides depreciation at 10% p.a. on the original cost. On 31st March, 1988, the machinery was sold for ` 1,20,000/-. Give the Machinery Account for three years.

Solution

In the Books of Company

Dr. **Machinery A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
1/04/85	To Cash A/c (P)		1,00,000	31/03/86	By Depreciation A/c		10,000
				31/03/8	By Balance c/d		90,000
			1,00,000				**1,00,000**
1/04/86	To Balance b/d		90,000	31/03/8	By Depreciation A/c		10,000
				31/03/8	By Balance c/d		80,000
			90,000				**90,000**
1/04/87	To Balance b/d		80,000	31/03/88	By Cash A/c		1,20,000
31/03/88	To P & L A/c (Profit)		50,000	31/03/88	By Depreciation A/c		10,000
			1,30,000				**1,30,000**

Illustration 3

Raj purchased following plant and machinery on various dates:

1.1.1986	` 50,000/-	1.7.1986	` 20,000/-
1.10.1987	` 40,000/-	1.4.1988	` 60,000/-
31.12.1989	` 1,00,000/-		

On 1.7.1989, he sold ½ of the machine bought on 1.1.1986 for ` 20,000/-.

He writes off depreciation on the fixed installment system which he has estimated to be 10% p.a. of the original cost. Prepare Machinery Accounts in the ledger of Raj for the year 1986, 1987, 1988 and 1989.

Solution

In the Books of Raj

Dr. **Machinery A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
01/01/86	To Cash A/c (P)		50,000	31/12/86	By Depreciation A/c		
01/08/86	To Cash A/c (P)		20,000	31/12/86	(5000 + 1000)		6,000
					By Balance c/d		64,000
			70,000				**70,000**
01/01/87	To Balance b/d		64,000	31/12/87	By Depreciation A/c		
01/10/87	To Cash A/c (P)		4,000		(5000 + 2000 + 1000)		8,000
				31/12/87	By Balance c/d		96,000
			1,04,000				**1,04,000**
01/01/88	To Balance b/d		96,000	31/12/88	By Depreciation A/c		
01/04/88	To Cash A/c (P)		60,000		(5000 + 6000 + 4000 + 4500)		15,500
				31/12/88	By Balance c/d		1,40,500
			1,56,000				**1,56,000**
01/01/89	To Balance b/d		1,40,500	01/07/89	By Cash A/c		20,000
01/07/89	To P & L A/c		8,750	01/07/89	By Depreciation A/c (Commission)		1,250
31/12/89	To Balance b/d		1,00,000	07/08/8	By Depreciation A/c (2500 + 2000 + 4000 + 6000 + 5000)		19,500
				31/03/89	By Balance c/d		2,08,500
			2,49,250				**2,49,250**
01/01/90	To Balance b/d		2,08,500				

Dr. **Depreciation A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
31/12/86	To Machinery A/c		6,000	31/12/86	By P & L A/c		6,000
			6,000				**6,000**
31/11/87	To Machinery A/c		8,000	31/12/87	By P & L A/c		8,000
			8,000				**8,000**
31/12/88	To Machinery A/c		15,500	31/12/88	By P & L A/c		15,500
			15,500				**15,500**
31/07/89	To Machinery A/c		15,750	31/08/89	By P & L A/c		15,750
			15,750				**15,750**

Illustration 4

Sanika Enterprises, Pune purchased furniture for ` 40,000 on 1st July, 2005. Additional furniture on 1st January, 2007 was purchased for ` 20,000. They charged depreciation at 15% p.a. on original cost.

On 1st October, 2007, they sold the furniture purchased on 1st July, 2005 for ` 32,000 and on the same date new furniture was purchased for ` 10,000. Show Furniture Account and Depreciation Account for the years 2005-06, 2006-07, and 2007-08 assuming that the financial year closes on 31st March, every year.

Solution

In the Books of Sanika Enterprises

Dr. Furniture A/c Cr.

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
01/07/05	To Cash A/c (P)		40,000	31/08/06	By Depreciation A/c		4,500
				31/08/0	By Balance c/d		25,500
			40,000				**40,000**
01/01/06	To Balance b/d		25,500	31/03/07	By Depreciation A/c		6,750
01/01/07	To Cash A/c (P)		20,000	31/03/07	By Balance c/d		38,750
			45,500				**45,500**
01/04/07	To Balance b/d		38,750	01/10/07	By Cash A/c		32,000
01/10/07	To P & L (P)		6,500	01/10/07	By Depreciation A/c		3,000
01/10/07	To Cash A/c (p)		10,000	31/03/08	By Depreciation A/c		3,750
				31/03/08	By Balance c/d		16,500
			52,250				**52,250**

Dr. Depreciation A/c Cr.

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
31/03/06	To Furniture A/c		4,500	31/03/06	By P & L A/c		4,500
			4,500				**4,500**
31/03/07	To Furniture A/c		6,750	31/03/07	By P & L A/c		6,750
			6,750				**6,750**
01/10/07	To Furniture A/c		3,000	31/03/08	By P & L A/c		6,750
31/03/08	To Furniture A/c		3,750				
			6,750				**6,750**

Working Notes:

1. Profit or loss on sale of machine (1/10/07)

Cost (01/07/05)	40,000
Less: Depreciation up to 31/03/07	10,500
W.D.V. (01/04/07)	29,500
Less: Depreciation for months (40,000 × 15% × 6/2)	3,000

W.D.V. (1/10/07)	26,500
Sold for	32,000
Profit on sale	6,500

2. Depreciation on balance in 2007

20,000 × 15%	=	3,000
10,000 × 15% × 6/2	=	7,50
		3,750

Problems for Practice

Q. 1. New Trading Company, Mumbai purchased Machinery for ` 90,000 on 1st April, 2008.

On 1st October, 2008, additional machinery was purchased for ` 60,000. On 1st October, 2010, the company sold the machinery purchased on 1st October, 2008 for ` 40,000.

Depreciation is to be charged at 10% p.a. under Straight Line Method on 31st March every year.

Prepare Machinery Account and Depreciation Account for three years, *i.e.*, 2008-09, 2009-10 and 2010-11.

Q.2. Ankita & Co., Solapur bought a machinery worth ` 25,000 on 1st April, 2004 and paid ` 5,000 on its installation. The company depreciation the machinery @ 10% p.a. on original cost on 31st March, every year.

On 1st October, 2006, the company sold a part of the machinery for ` 7,000, the original cost of which was ` 10,000, the company purchased new machinery for ` 20,000 on the same date show Machinery Account and Depreciation Account for the year 2004-05, 2005-06 and 2006-07.

Q.3. Radhika Traders purchased Office Furniture on 1st October, 2006 for ` 46,000 and spent ` 16,000 for its Fixation.

The estimated life of the furniture to be 10 years. Radhika Traders also estimated that the scrap value at the end of its life would be ` 12,000. The entire furniture was sold for ` 47,000 on 1st October, 2009.

Show Furniture Account and Depreciation Account for the years 2006-07, 2007-08, 2008-09 and 2009-10 assuming that the accounts were closed on 31st March, every year.

WRITTEN DOWN VALUE METHOD

Under this method, depreciation is charged at a certain percentage each year on balance of the asset which is brought forward from the previous year. The amount of depreciation charged in each period is not fixed but it goes on decreasing gradually, as the opening balance of the asset in each year will reduce. In other words, a fixed rate on the written down value of the asset is charged as depreciation every year over the expected useful life of the asset. Thus, the amount of depreciation becomes higher at the earlier period and becomes gradually lower in subsequent periods, when repairs and maintenance charges increase gradually.

As the depreciation is charged on Written Down Value (*i.e.*, cost less total depreciation), this method is called as *"Written Down Value Method"*. Similarly, as the amount of depreciation per year goes on reducing every year upto the useful life of the asset, it also called as *"Reducing Balance Method"* or *"Diminishing Balance Method"*.

If this method of depreciation is followed, the amount of depreciation remains higher but repairing and maintenance charges remains very low in the earlier years. In the later years, amount of depreciation remains low while amount of repairing and maintenance charges remains higher. It means the total charges of depreciation and repairs and maintenance debited to profit and loss account every year remains more or less same. As a result, profit remains constant over the number of years. This method of depreciation is more logical, scientific and realistic as compared to other methods of depreciation. This method of depreciation is accepted under the Income Tax Act. Under this method of depreciation, assets are never completely written off. Because of this, some charges however they are small, are made to revenue to save the taxes. Under this method of depreciation, higher amount of depreciation is charged in the initial years gets match with the higher revenues earned from the increased production carried out by the use of new assets.

Features:

1. The rate of deprecation is fixed.
2. The depreciation is computed on reducing balance of the asset.
3. The annual depreciation diminishes as the asset gets older.
4. The value of asset never becomes zero even after the economic life of the asset.

Merits:

1. It is not necessary to calculate every year the additions made to the asset.
2. It is simple and easy to understand.
3. Since the asset is not completely written off, some charge is made to revenue every year.
4. It is generally followed by every business concern and even tax authority.

Demerits:

1. Interest on capital invested in the asset is not considered.
2. Determination of suitable rate of depreciation is difficult.

Difference between Straight Line Method and Written Down Value Method

	Straight Line Method	**Written Down Value Method**
1	**Meaning**	
	The method of depreciation in which depreciation is charged at a fixed percentage on the original cost of fixed asset every year is called Straight Line Method of depreciation.	The method of depreciation in which depreciation is charged at a fixed percentage on the written down value of fixed asset at the beginning of each year is called ‘Written Down Value Method’.
2	**Depreciation charged**	
	Depreciation is charged on the original cost of the asset every year.	Depreciation is charged on the written down value (cost less total depreciation) of the asset every year.
3	**Book value/Zero balance**	
	The book value of the asset becomes zero or to scrap value at the end of its useful life.	The book value of the asset never becomes zero or to scrap value at the end of its useful life.

4	**Amount of Depreciation**	
	The amount of depreciation remains constant for all the years.	The amount of depreciation goes on reducing every year.
5	**Recognition/Acceptability**	
	This method of depreciation is not recognised or accepted by the Income tax authority.	This method of depreciation is recognised or accepted by the Income tax authority.
6	**Suitability**	
	This method is suitable where repair charges are less and obsolescence is not frequent.	This method is suitable where repair charges are more in later years and also obsolescence.

Ist Method **Straight Line Method** **Or** **Fixed Installment Method** **Or** **Original Cost Method**		**IIst Method** **Written Down Value Method** **Or** **Reducing Balance Method** **Or** **Diminishing Balance Method**	
Example:	`	**Example:**	`
Cost (1/1/2008) *Less:* Depreciation 2008 10% p.a.	10,000 (1000)	Cost (1/1/2008) *Less:* Depreciation 2008 10% p.a.	10,000 (1000)
Book value/W.D.V./Balance $\frac{31/12/08}{01/01/09}$ *Less:* Depreciation 2009 10% p.a.	9000 (1000)	Book value/W.D.V./Balance $\frac{31/12/08}{01/01/09}$ *Less:* Depreciation 2009 10% p.a.	9000 (900)
Book value/W.D.V./Balance $\left(\frac{31/12/09}{01/01/10}\right)$ *Less:* Depreciation 2010 10% p.a.	8000 (1000)	Book value/W.D.V./Balance $\left(\frac{31/12/09}{01/01/10}\right)$ *Less:* Depreciation 2010 10% p.a.	8100 (810)
Book value/W.D.V./Balance $\left(\frac{31/12/10}{01/01/11}\right)$	7000	Book value/W.D.V./Balance $\left(\frac{31/12/10}{01/01/11}\right)$	7290

Illustration 5

Wasim Raja & Co. purchased following Plant & Machinery on the dates mentioned hereunder

1st Jan, 1986	` 5,000/-	1st April, 1987	` 2,000/-
1st July, 1987	` 4,000/-	1st April, 1988	` 6,000/-

On 1st July, 1989, they sold the machine bought on 1st January, 1986 for ` 4,000/-. They write off depreciation on the Reducing Balance Method @ 20% p.a. on 31st December every year.

Prepare Machinery Account in the ledger of Wasim Raja & Co. for the years 1986, 1987, 1988 and 1989.

Solution

In the Books of Wasim Raja & Co

Dr. **Machinery A/c** **Cr.**

Date	Particulars	JF	`	Date	Particulars	JF	`
01/01/86	To Cash/Bank A/c		5,000	31/12/86	By Depreciation A/c		1,000
				31/12/86	By Balance c/d		4,000
			5,000				**5,000**
01/01/87	To Balance b/d		4,000	31/12/87	By Depreciation A/c		1,200
01/04/87	To Cash/Bank A/c		2,000		(W.N. 1)		
01/07/87	To Cash/Bank		4,000	31/12/87	By Balance c/d		8,800
			10,000				**10,000**
01/01/88	To Balance b/d		8,800	01/12/88	By Depreciation A/c		2,660
01/04/88	To Cash/Bank A/c		6,000		(W.N. 2)		
				31/12/88	By Balance c/d		12,140
			14,800				**14,800**
01/01/89	To Balance b/d		12,140	01/07/89	By Cash/Bank A/c		4,000
01/07/89	To P & L A/c (Profit on Sale) (W.N. 3)		1696	01/07/89	By Depreciation A/c (Machinery sold)		2,56
				31/12/89	By Depreciation A/c (on balance) (W.N. 4)		1,916
				31/12/89	By Balance c/d		7,664
			13,836				**13,836**
01/01/90	To Balance b/d		7,667				

Working Notes

1. Depreciation for 1987:

` 4,000 × 20%	` 800
` 2,000 × 20% × 9/2	` 300
` 1,000 × 20% × 6/12	` 100
	` 1,200

2. Depreciation for 1988:

` 8,800 × 20%	` 1,760
` 6,000 × 20% × 9/12	` 900
	` 2,660

3. Machinery sold on 01/07/89:

Cost (01/01/86)	` 5,000
Less: Depreciation for 1986 @ 20%	` 1,000

W.D.V. (01/01/87)	` 4,000
Less: Depreciation @ 20%	` 800
W.D.V. (01/01/88)	` 3,200
Less: Depreciation @ 20%	` 6,40
W.D.V. (01/01/89)	` 2,560
Less: Depreciation @ 20% for 6 months	` 2,56
W.D.V. (01/07/89)	` 2,304
Sold for	` 4,000
Profit	` 1,696

4. Depreciation on Balance for 1989:

W.D.V. (01/01/89)	` 12,140
Less: W.D.V. of M. Sold (1/01/89)	` 2,560
Balance	` 9,580
Depreciation @ 20%	` 1916

Illustration 6

The Machinery Account in the books of Ramji & Co., showed a balance of ` 7,540/- as on 1st January, 1990. They purchased a new machinery of ` 2,200/- on 1.7.1990. They have also sold an old machine on 1.1.1990 at a price of ` 5,000/-. This machine was purchased on 1.1.1987 for ` 7,500/-.

Ramji & Co. writes off depreciation @ 20% on Reducing Balance Method. Prepare Machinery Account for the year 1990.

Solution

In the Books of Ramji & Co.

Dr. **Machinery A/c** **Cr.**

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
01/01/90	To Balance b/d		7,540	01/01/90	By Cash/Bank A/c		5,000
01/01/90	To P & L A/c		1,160	31/12/90	By Depreciation A/c		960
01/07/90	To Cash/Bank A/c		2,200		(W.N. 2)		4,940
			10,900	31/12/90	To Balance c/d		**10,900**
01/0191	To Balance b/d		4,940				

Working Notes

1. Machine sold on 01/01/90:

Cost (01/01/87)	` 7,500
Less: Depreciation @ 20%	` 1,500
W.D.V. (01/01/88)	` 6,000
Less: Depreciation @ 20%	` 1,200
W.D.V. (01/01/89)	` 4,800
Less: Depreciation @ 20%	` 960

Less: W.D.V. (01/01/90)	` 3,840
Sold for	` 5,000
Profit on sale	` 1,160

2 Depreciation on balance machine and new purchase for 1990:

Opening	` 7,540
Less: W.D.V. (1/01/90)	
(Machinery sold)	` 3,840
	` 3,700
Depreciation @ 20%	` 740
On new machine	
` $2200 \times 20\% \times \frac{6}{12}$	` 220
Total	**` 960**

Illustration 7

The Machinery Account in the books of Joker shows a debit balance of ` 15, 000/- on 1st April, 1990.

(i) On 1st October, 1990, he purchased a Machinery COSTING ` 10,000/-.

(ii) On 1st January, 199, he sold out one old machine for ` 2,000 whose book value at the beginning of the year was ` 3,000.

Machinery is to be depreciated at the fixed rate of 10% on diminishing balance method.

Show the Machinery Account for the year ending 31st March, 1991.

Solution

In the Books of Joker

Dr. Machinery A/c Cr.

Date	Particulars	J.F.	`	Date	Particulars	J.F.	`
01/04/90	To Balance b/d		15,000	01/01/91	By Cash/Bank A/c		2,000
01/10/90	To Cash/Bank A/c		10,000	01/01/91	By P & L A/c		775
				01/01/91	By Depreciation A/c		
					(Machinery sold)		225
				31/03/91	By Depreciation A/c		
					(W.N. 2)		1,700
				31/03/91	By Balance c/d		20,300
			25,000				**25,000**
01/04/91	To Balance b/d		20,300				

Working Notes

1. Sale of Machinery on 01/01/91:

Book Value on 01/04/90	` 3,000
Less: Depreciation @ 10% for 9 months	` 225

W.D.V. (01/01/91)	₹ 2,775
Sold for	₹ 2,000
Loss on Sale	₹ 775

2. Depreciation on balance and purchased during the year:

Opening (01/04/90)	₹ 15,000
Less: Book value of machine sold	₹ 3,000
	₹ 12,000
Depreciation @ 10% × 12,000	₹ 1,200
New Purchase (10,000 × 10% × 6/12)	₹ 500
Total Depreciation	₹ 1,700

Problems for Practice

Q. 1. M/s Subhash & Co. purchased machinery on 1st April, 2011 for ₹ 1,50,000.

Additional machinery was purchased on 30th September, 2011 for ₹ 20,000. On 31st March, 2014, the machinery purchased on 30th September, 2011 became obsolete and was sold for ₹ 12,000.

The company provides depreciation @ 20% p.a. on Reducing Balance Method on 31st March every year.

Prepare Machinery Account and Depreciation Account for 3 years ending 31st March, 2014.

Q.2. ABC & Co. purchased furniture on 1st April, 2011 for ₹ 60,000. Additional furniture was purchased on 1st October, 2011 for ₹ 30,000.

On 1st October, 2013, the company sold half of the furniture purchased on 1st April, 2011 for ₹ 20,000.

Depreciation was to be provided annually on 31st March under Written Down Value Method @ 10% p.a.

Show Furniture Account and Depreciation Account for 2011-12, 2012-13 and 2013-14.

Q.3. M/s Medha Trading Company, Nasik, purchased machinery of ₹ 1,20,000 on 1st April, 2011. Additional machinery costing ₹ 80,000 was purchased on 1st October, 2011.

On 1st October, 2013, machinery which had cost ₹ 20,000 on 1st April, 2011, was sold for ₹ 10,000.

Company provides depreciation @ under Written Down Value Method on 31st March every year.

Prepare Machinery Account and Depreciation Account for 3 years ending 31st March, 2014.

When Provision for Depreciation Account is Maintained

Under this method, the amount of depreciation is charged to (debited to) the Depreciation Account and credited to the provision for Depreciation Account. The Asset Account appears in the Balance Sheet at its original value (cost price) on the asset side. Depreciation Account, being nominal Account, is transferred to Profit & Loss Account at the end of the accounting year while provision for Depreciation Account appears in the Balance Sheet on liability side or deducted from asset side from concerned asset.

In case the asset is sold, the Provision for Depreciation on the asset sold is transferred to the Asset Account. Similarly, the amount realized from the sale of asset is also transferred to Asset Account. The balance, if any, in the Asset Account is either Profit or Loss, being transferred to Profit & Loss Account.

The journal entries under this method are as follows:

1. For purchase of asset:

Asset A/c Dr.

To Cash/Bank/Party's (Supplier's) A/c

(Being asset purchased for cash or on credit)

2. For expenses paid on asset:

Asset A/c Dr.

To Cash/Bank A/c

(Being expenses paid on asset)

3. At the end of every accounting year:

(a) For providing depreciation:

Depreciation A/c Dr.

To Provision for Depreciation A/c

(Being depreciation charged on asset for the year ___ at ___ % p.a. by FIM/RBM)

(b) For transfer of depreciation to Profit & Loss A/c:

Profit & Loss A/c Dr

To Depreciation A/c

(Being depreciation for the year ___ transfer to Profit & Loss A/c)

Or

(Being balance in depreciation A/c transfer to Profit & Loss A/c)

4. For sale of asset:

(a) For sale proceeds of Asset

Cash/Bank/Party's (Purchaser's) A/c Dr.

To Asset A/c

(Being asset sold for cash or on credit)

(b) For depreciation on asset sold (according to the period of use, *i.e.*, 1st day of accounting year till the date of sale):

Depreciation A/c Dr.

To Provision for Depreciation A/c

(Being depreciation charged on asset sold for ___ period at ___ % p.a. by FIM/RBM)

(c) For transfer of total provision for Depreciation A/c on asset sold to Asset A/c (transfer accumulated depreciation on asset sold to Asset A/c)

Provision for Depreciation A/c Dr.

To Asset A/c

(Being provision for Depreciation A/c on asset sold transfer to Asset A/c)

OR

(Being accumulated depreciation on asset sold transfer to Asset A/c)

(d) Entry for profit or loss on sale of asset:

Profit or Loss = Selling Price – Book Value of the Asset Sold as on Date of Sale

If profit:

Asset A/c Dr.

To Profit & Loss A/c

(Being profit on sale of asset transferred to Profit & Loss A/c)

If loss:

Profit & Loss A/c Dr.

To Asset A/c

(Being loss on sale of asset transferred to Profit & Loss A/c)

Proforma Ledger Accounts
In the Books of ……………

Dr. **Asset A/c** **Cr.**

Date	Particulars	J.F.	Amt.	Date	Particulars	J.F.	Amt.
	To Balance b/d		XX		By Balance c/d (Closing balance)		XX
	To Cash/Bank/Party's A/c (Purchase of asset)		XX ↑				
			XX				**XX**
	To Balance b/d		XX		By Balance c/d (Closing balance)		XX
	To Cash/Bank/Party's A/c (Purchase of asset)		XX ↑		By Cash/Bank/Party's A/c (Sale of Asset)		XX
			XX		By Provision for Depreciation A/c (Transfer of PFD on asset sold)		XX
	To Balance b/d		XX				
	To Profit & Loss A/c (Profit on sale of asset)		XX ↑		By Profit & Loss A/c (Loss on sale of Asset)		XX
			XX				**XX**
			XX		By Balance c/d (Closing Balance)		XX

Dr. **Provision for Depreciation A/c** **Cr.**

Date	Particulars	J.F.	Amt.	Date	Particulars	J.F.	Amt.
	To Balance c/d (Closing Balance)		XX		By Balance b/d		XX
					By Depreciation A/c		XX
			XX				XX
	To Balance c/d (Closing Balance)		XX		By Balance b/d		XX
					By Depreciation A/c		XX
			XX				XX
	To Asset A/c		XX		By Balance b/d		XX
	To Balance c/d (Closing Balance)		XX		By Depreciation A/c (on asset sold)		XX
					By Depreciation A/c		XX
			XX				**XX**

Dr. **Depreciation A/c** **Cr.**

Date	Particulars	J.F.	Amt.	Date	Particulars	J.F.	Amt.
	To Provision for Dep. A/c		XX		By Profit & Loss A/c		XX
			XX				XX
	To Provision for Dep. A/c		XX		By Profit & Loss A/c		XX
			XX				XX
	To Provision for Dep. A/c		XX		By Profit & Loss A/c		XX
			XX				XX
	To Provision for Dep. A/c		XX				
			XX				

DIFFERENCE BETWEEN PROVISIONS AND RESERVES

	Provisions	Reserves
1	**Nature**	
	Provision is a charge on the profit, *i.e.*, charge against profit.	Reserve is an appropriation of profit.
2	**Purpose**	
	It required for future liabilities and charges or for valuation adjustment.	It is created for safeguarding the business against unforeseen loses or for capital formation.

3	**Disclosure**	
	Usually provisions are debited to Profit and Loss Account.	Usually reserves are debited to Profit and Loss Appropriation A/c.
4	**Investment**	
	It is not invested any where.	It may be invested outside the business.
5	**Utilization**	
	It cannot be used for distribution of dividend.	It can be used for distribution of dividend.
6	**Compulsion**	
	Provisions are made mainly due to legal compulsion.	Reserves are created out of profits as a matter of prudence or safety.
7	**Presentation**	
	It is shown either as a liability under the head 'current liabilities' or as a deduction from the asset.	A Reserve is shown on the liability side of Balance Sheet under the head 'Reserves and Surplus'.

Illustration 8

A company whose accounting year is the calender year purchased on 1st April, 2004, machinery costing ` 30,000.

It further purchased on 1st October, 2004, machinery costing ` 20,000 and on 1st July, 2005, it purchased additional machinery costing ` 10,000

On 1st July, 2006, one-third of the machinery which was installed on 1st April, 2004, become obsolete and was sold for ` 3,000.

Show how the machinery account would appear in the books of the company the machinery being depreciated at 10% per annum on the Fixed Instalment Method and a separate Provision for Depreciation A/c being maintained for the year 2004, 2005 and 2006.

Solution

Dr. **Machinery A/c** **Cr.**

Date	Particulars	`	Date	Particulars	`
01/04/04	To Cash/Bank A/c	30,000	31/12/04	By Balance c/d	50,000
01/10/04	To Cash/Bank A/c	20,000			
		50,000			**50,000**
01/01/05	To Cash/Bank A/c	50,000	31/12/05	By Balance c/d	60,000
01/07/05	To Cash/Bank A/c	10,000			
		60,000			**60,000**
01/01/06	To Balance b/d	60000	01/07/06	By Bank A/c	3,000
			01/07/06	By P & L A/c (Loss)	4,750
			010/7/06	By Provision for Dep. A/c (Dep. on machine sold)	2,250
			31/12/06	By Balance c/d	50,000
		60,000			**60,0000**
01/01/07	To Balance b/d	50,000			

Workings:

1. Depreciation for 2004:

` 30,000 × 10% × 9/12 = ` 2,250
` 20,000 × 10% × 3/12 = ` 500
= ` 2,750

Dr. **Provision for Depreciation A/c** **Cr.**

Date	Particulars	`	Date	Particulars	`
31/12/04	To Balance c/d	2,750	31/12/04	By Depreciation A/c (W.N. 1)	2,750
		2,750			**2,750**
31/12/05	To Balance c/d	8,250	01/01/05	By Balance b/d	2,750
			31/12/05	By Depreciation A/c	5,500
		8,250			**8,250**
010/7/0	To Machinery A/c (Dep. on machine sold)	2,250	01/01/06	By Balance b/d	8,250
31/12/06	To Balance c/d	11,500	01/07/06	By Depreciation A/c (on machine sold)	500
			31/12/06	By Depreciation A/c (on balance)	5,000
		13,750			**13,750**
			01/01/07	By Balance b/d	11,500

2. Depreciation for 2005:

` 30,000 × 10% = ` 3,000
` 20,000 × 10% = ` 2,000
` 10,000 × 10% $\frac{6}{12}$ = ` 500
` 5,500

3. For 2006:

$\frac{1}{3}$ Machine sold (1/7/06)	10,000
($\frac{1}{3}$ × ` 30,000) (1/4/04)	
Less: Depreciation @ 10%	
(for 9 mths)	750
W.D.V. (1/01/05)	9,250
Less: Depreciation @ 10%	1,000
W.D.V. (1/1/06)	8,250
Less: Depreciation @ 10%	500
(for 6 months)	
W.D.V. 1/7/06	7,750
Sold for	3,000
Loss on sale	**4,750**

4. Depreciation for 2006

` 20,000 × 10% = ` 2,000
` 20,000 × 10% = ` 2,000
` 1,000 × 10% = ` 1000
` 5,000

Illustration 9

Rajesh maintains his fixed assets at cost. Depreciation provision accounts are maintained separately for each asset. On 31st Dec., 2005, the position was as under:

	Cost `	Depreciation `
Plant and Machinery	1,50,710	62,350
Furniture and Fixture	26,450	11,500

He purchased a machine for ` 10,000 on 1st April, 2006 and furniture for ` 3,000 on 1st June, 2006. A machine purchased on 1st January, 2004 for ` 6,000 was sold on 30th June, 2006 for ` 5,500.

Depreciation is provided @ 10% p.a. on Written Down Value method. Show the relevant account for the year ended 31st December, 2006.

Solution

In the Books of Rajesh

Dr. Plant and Machinery A/c Cr.

Date	Particulars	`	Date	Particulars	`
01/01/06	To Balance b/d	1,50,710	30/6/06	By Cash/Bank A/c	5,500
01/04/06	To Cash/Bank A/c	10,000	30/6/06	By Provision for Dep. A/c	1,383
30/06/06	To P & L A/c (Profit)	883		(Dep. on Machinery sold)	
			31/12/06	By Balance c/d	1,54,710
		1,61,593			**1,61,593**

Provision for Depreciation A/c

Dr. (Plant and Machinery) Dr.

Date	Particulars	`	Date	Particulars	`
30/06/06	To Machinery A/c (Dep. an machine sold)	1,383	01/01/06	By Balance b/d	62,350
			30/06/06	By Depreciation A/c (on machine sold)	243
31/12/06	To Balance c/d	76,575	31/12/06	By Depreciation A/c (on balance) (W.N. 7)	15,335
		77,928			**77,928**

Working Notes:

Sold on 30/6/06

1.

Machine cost (1/1/04)	` 6,000
Less: Depreciation @ 10%	` 600
W.D.V. (1/1/05)	` 5,400
Less: Depreciation @ 10%	` 540
W.D.V. (1/1/06)	` 4,860
Less: Depreciation @ 10% (6 months)	` 243
W.D.V. (30/6/06)	` 4,617
Sold for	` 5,500
Profit on sale	` 883

2. Depreciation on balance:

Cost on 1/1/06	` 1,50,710
Less: Machine Sold Value (1/1/06)	` 4,860
	` 1,45,850
` 1,45,850 × 10%	` 14,585
` 10,000 × 10 × $\frac{9}{12}$	= ` 750
Total	` 15,335

Dr. Furniture Fixture A/c Cr.

Date	Particulars	`	Date	Particulars	`
01/01/06	To Balance b/d	26,450	31/12/06	By Balance c/d	29,450
01/04/06	To Cash/Bank A/c	3,000			
		29,450			**29,450**

Dr. Provision for Depreciation A/c Cr.

Date	Particulars	`	Date	Particulars	`
31/12/06	To Balance b/d	13,170	01/01/06	By Balance c/d	11,500
			31/12/06	By Depreciation A/c (W.N. 1)	1,670
		13,170			**13,170**

Working Note:

1. Depreciation for the year 2006:

   On opening balance

   Cost ` 26,450 Provision ` 11,500 = W.D.V.

   For depreciation ` 14,950

   @ 10%

   ` 1,495

   On new purchase:

   ` $3{,}000 \times 10\% \times \frac{9}{12}$ ` 175

   ` 16,70/-

Illustration 10

A machinery having original cost in the books as on 1st April, 2008 at ` 20,000 was sold for ` 12,000 on 30th September, 2008. ` 7,500 was set aside by the firm by way of depreciation on the machinery upto 31st March, 2007.

On 1st January, 2009, new machinery was purchased for ` 25,000

The accounts were closed on 31st March every year and depreciation was provided @ 10% on original cost of machinery.

Show Journal Entries and Prepare and necessary ledger accounts, if Provision for Depreciation Account is maintained for the year 2008-09.

Solution

Journal Entries

Date	Particulars	L.F.	Debit `	Credit `
30/09/08	Cash/Bank A/c Dr. To Machinery A/c To P & L A/c (Being machine sold and profit recorded).		12,000	 11,500 500

30/09/08	Depreciation A/c Dr. To Provision for Depreciation A/c (Being depreciation charge during year on machine sold)		1,000	1,000
30/09/08	Provision for Depreciation A/c Dr. To Machinery A/c (Being accumulate depreciation machine sold on transfer)		8,500	8,500
01/01/09	Machinery A/c Dr. To Cash/Bank A/c (Being new machinery purchased)		25,000	25,000
31/03/09	Depreciation A/c Dr. To Provision for Depreciation A/c (Being depreciation charged during year)		625	625
31/03/09	P & L A/c Dr. To Depreciation A/c (Being depreciation transfer P & L A/c)		1,625	1,625

Dr. **Machinery A/c** **Cr.**

Date	Particulars	L.F.	`	Date	Particulars	L.F.	`
01/04/08	To Balance b/d		20,000	30/09/08	By Cash/Bank A/c		12,000
30/09/08	To P & L A/c		500	30/09/08	By Provision for Depreciation A/c		8500
01/01/09	To Cash/Bank A/c		25,000	31/03/09	By Balance c/d		25000
			45,500				**45,500**

Dr. **Provision Depreciation A/c** **Cr.**

Date	Particulars	`	Date	Particulars	`
30/09/08	To Machinery A/c (Dep. on machine sold)	8,500	1/4/08	By Balance b/d	7,500
			30/9/08	By Depreciation A/c	1,000
31/03/09	To Balance c/d	625	31/3/09	By Depreciation A/c	625
		9,125			**9,125**

Notes:

1. Sale of machinery on 30/09/08:

Original cost 1/1/08	20,000
Less: Depreciation upto date (6 months)	7,500
	12,500

	W.D.V.	
	Less: Depreciation @ 10% (6 months) (20000 × 10%)	1000
	W.D.V. (30/9/08)	11,500
	Less: Selling Price	12,000
	Profit on sale	500
2	Depreciation on balance machinery:	
	` 25,000 × 10% × 3/12	= ` 625

Problems for Practice

Q.1. On 1st April, 2003, a firm purchased a machinery for ` 2,00,000. On 1st October, in the same year, new machinery was purchased for ` 1,00,000.

On 1st October, 2004, the machinery purchased on 1st April, 2003 was sold for ` 90,000. On 1st October, 2005, additional new machinery was purchased for ` 2,50,000.

The firm provides depreciation on machinery @ 10% under Reducing Balance Method on 31st March every year.

Pass Journal Entries and also prepare Machinery Account, Provision for Depreciation Account and Depreciation Account for 3 year ending upto 31st March, 2006.

Q. 2. On 1st April, 2009, following balances appeared in the Books of Mangesh Traders; Machinery A/c ` 4,00,000, Provision for Depreciation A/c ` 1,60,000. On the above date, they decided to sell the machinery for ` 1,00,000 which was purchased on 1st April, 2006 for ` 1,50,000.

The firm provides depreciation on 31st March every year @10% p.a. under Straight Line Method.

Show Machinery Account and Provision for Depreciation Account as on 31st March, 2010.

EXERCISE

Match the Column

Group 'A'	Group 'B'
1. Diminishing balance method	(a) Assets at original cost recorded
2. Current assets	(b) Value of asset never become zero
3. Scrap value	(c) Depreciation is charge
4. Fixed assets	(d) Expected value on disposal of asset
5. Provision for depreciation	(e) Depreciation is not charged
	(f) Depreciation on original cost

Ans: 1. (b), 2. (e), 3. (d), 4. (c), 5. (a).

Fill in the blanks

1. Depreciation is ________ in the value of asset.
2. All ________ assets are depreciated.
3. Under ________ system, the amount of depreciation change every year.

4. ________ Method in which depreciation remains constant.
5. At the end of the year, depreciation is transferred to ________ account.
6. In any method of depreciation, depreciation is charged on ________ of the asset in first year.
7. Depreciation account is a ________ account.
8. Depreciation is ________ to the business.
9. Amount spent on installation of new machinery is ________ to the cost of the machine.
10. Rate of depreciation depends upon the ________ of the asset.
11. Profit or loss on sale of the asset is transferred to ________ account.

Ans. 1. decline, 2. fixed, 3. written down value, 4. fixed installment, 5. Profit and Loss A/c, 6. cost, 7. nominal, 8. loss/expenditure, 9. added, 10. economic life, 11. Profit and Loss A/c.

PROBLEMS

(A) Fixed Installment Method

Q1. Kunal Kapoor purchased some Plant & Machinery on 1.4.11 for ` 4,500/- and spent ` 500/- on erection. On 1.10.12, he sold the machine for ` 4,000/- and on the same date purchased another machine for ` 10,000/-.

He writes off depreciation on Fixed Installment System which he has estimated to be 10% p.a. accounting year of the company closes on 31st March every year.

Pass Journal entries and also prepare Machinery A/c and Depreciation A/c for the year 2011-2012, 2012-2013 and 2013-2014.

Q.2. From the books of Mr. Amitabh, the following particulars regarding Machinery A/c are available. Prepare the Machinery A/c for the year 2014 assuming that depreciation is written off at 10% p.a. on Straight Line Method.

(a) Balance on 1.1.2014 ` 52,000/-.

(b) Purchased of machinery on 1.7.2014 ` 20,000.

(c) Installation charges for purchase of new machine on 1.7.2014 ` 5,000.

(d) Sale on 1.10.2014 for ` 22,000 of machinery originally costing ` 20,000 on 1.7.2012.

(e) The opening balance includes Machinery purchased on 31.12.2013 for ` 35,000.

Q.3. M/s. Sharad Agency showed a debit balance of ` 36,000/- to the Machinery A/c on 1.7.2010.

The original cost of machinery was ` 60,000/-.

On 1st January, 2011, Sharad Agency bought an additional Machinery of ` 48,000/- and spent ` 2,000/- for its installation. One more machinery costing ` 25,000/- was purchased on 30.6.2011.

On 30.6.2013 a part of machinery acquired on 1st January, 2011 was sold for ` 7,250/- the original cost of which was ` 10,000/-.

On 31.12.2013, the Agency sold out the machinery for ` 16,000/- which was purchased on 30.6.2011.

Agency charged 10% depreciation in fixed installment basis and their financial year closed on 30th June every year.

Show Machinery Account for the year 2010-11, 2011-12, 2012-13 and 2013-14.

(B) Reducing Balance Method

Q.4. Aurangabadkar purchased furniture worth ` 20,000/- on 1.1.2012. He charges depreciation at the rate of 10% on Reducing Balance Method. On 1.7.2013, he sold out a part of the furniture for ` 2,000/-, the original cost of which on 1.1.2012 was ` 4,000/-. The financial year of Aurangabadkar ends on 31st March every year.

You are required to prepare his Furniture Account for the first four years, and to pass journal entries for the transaction of the fourth year.

Q.5. Ankita Trading Company, Pune purchased furniture on 1st April, 2012 for ` 25000. In the same year, additional furniture was purchased for ` 10,000 on 1st October, 2012.

On 1st October, 2013, the furniture purchased on 1st April, 2012 was sold for ` 15,000 and on the same date new furniture was purchased for ` 12,000.

The company charge depreciation @ 8% p.a. on Diminishing Balance Method.

Pass Journal entries and also prepare Furniture A/c and Depreciation A/c for 3 years, *i.e.*, 2012-13, 2013-14 and 2014-15, assuming that the accounting year of the company closes on 31st March every year.

Q.6. XYZ & Company, Jalgaon purchased a building for ` 8,00,000 on 1st July 2011. On 1st April, 2012, an extension was made to the above building by spending ` 4,00,000.

On 1st October, 2013, half of the building was sold for ` 5,60,000 and brokerage at 2% of the selling price was paid.

Depreciation is charged on 31st March every year @ 10% p.a. under diminishing balance method.

Prepare Building Account and Depreciation Account for 2011-12, 2012-13 and 2013-14.

(C) When Provision for Depreciation A/c is Maintained

Q.7. M/s. Vishal Traders, Bombay, purchased Machinery on 1.1.2012 for ` 68,000. The Installation Charges amounted to ` 2,000/-. They decided to depreciate the machinery at 10% per annum under fixed installment system. On 1.7.2014 a machinery having original cost of ` 10,000/- was sold for ` 5,000/- and on the same date a new machinery amounting to ` 10,000/- was purchased. Pass journal entries in the trader's book and also prepare Machinery A/c, Provision for Depreciation A/c and Depreciation A/c from 1.1.2012 to 31.12.2014. The accounts of the firm are closed on 31st December every year.

Q.8. Sangam Trading Co. purchased some machinery on 1.1.2012 costing ` 88,000/- and spent ` 2,000/- on its erection. On 30.6.2012, additional machinery is purchased for ` 10,000/-

On 31.12.2013, part of the machinery was sold for ` 2,100/- which had a cost price of ` 4,000/- on 1.1.2012.

Prepare Machinery A/c, Provision for Depreciation A/c and Depreciation A/c for the year 2012, 2013 and 2014 and pass journal entries for the year 2013 assuming that machinery is depreciated at 10% p.a. on diminishing balance method on 31st Dec., each year.

8 CHAPTER

Final Accounts

INTRODUCTION

Accounting is the recording and reporting of business transactions. Business transactions involve activities of actual business (selling goods or services), investment (purchasing assets) and financing (raising money for investment). In accounting, business activities give rise to revenue income and revenue expenditure, Investment activities give rise to capital expenditure. Financing activities give rise to capital receipts. P & L A/c is a summary of revenue income and revenue expenses. Balance Sheet is summary of capital receipts and capital expenditure.

Thus, preparation of final accounts is the last step in the accounting cycle. In fact, final accounts include a number of accounts such as: (i) trading accounts, (ii) profit and loss account, and (iii) balance sheet. Though balance sheet is a statement, for all practical purposes, it is treated as one of the final accounts. Once the "trial balance" is extracted and 'errors' rectified, a trader prepares the "final accounts" so as to know the final results (*i.e.*, net profits or loss) and the financial position (*i.e.*, assets and liabilities) of his business. Trading account and profit and loss account concerning goods by passing entries known as "closing entries". All remaining accounts, *viz*., real and personal account pertaining to properties, debtors and creditors are just shown in statement called balance sheet.

Manufacturing Account

Those concerns which are converting raw materials into finished goods and then sell the finished goods, are required to prepare manufacturing account besides preparing trading and profit and loss account. This account is prepared to calculate the cost of goods manufactured, which is transferred to the trading account. The expenses relating to the factory are transferred to manufacturing account. The main object of manufacturing account is to show:

(i) Cost of finished goods produced and

(ii) Constituent items thereof such as cost of material consumed, productive wages, direct and indirect expenses.

Features of Manufacturing Account

(a) Stock of Finished Goods

Since the main purpose of preparing this account is to find out the cost of goods produced during the year, the opening and closing stock of finished gods are not to be shown in this account. They will be shown in the trading account.

(b) Raw Material Consumed

The cost of raw materials consumed during the year is to be debited in the account. It can be found out as follows:

Cost of raw material consumed	
Opening stock of raw materials	×××
Add: Purchase of raw materials	×××
Less: Closing stock of raw materials	×××
	×××

(c) Work-in-progress (Partly Finished Stock)

In a manufacturing business concern, there are always some unfinished goods, the cost of closing work-in-progress is credited in the account, shown in the balance sheet and debited to the manufacturing account of the next year as an opening balance.

(d) Factory Expenses

All factory expenses are debited to this account. Example, rent, rates, salaries of supervising staff, light, heat and fuel, repairs and renewals, depreciation relating to factory property (*i.e.*, machinery) etc.

(e) Sale of Scrap

Scrap is the incidental residue from certain types of manufacture. The value realized from the sale of scrap is credits to the manufacturing account.

(f) Cost of Production

At this stage, the difference between the two sides of the manufacturing account, shows the cost of goods produced during the year.

The balancing figure in the account is the cost of goods manufactured which will be debited to trading account. The trading account therefore, will compromise only the opening stock of finished goods, cost of goods manufactured, sales (less sales returns), and the closing stock of finished goods. A proforma of manufacturing account is given below:

Manufacturing A/c for the year ended 2014

Particulars		`	**Particulars**	`
To Work-in-progress (opening)		xxx	By Sales of scrap	xxx
To Material used			By Work-in-progress (closing)	xxx
Opening stock				
Add: Purchases	xxx	xxx		
Less: Closing stock	xxx			
To Wages	xxx	xxx	By Cost of goods produced	
To Factory expenses		xxx	transferred to Trading A/c	
To Purchase expenses		xxx	(balancing figure)	xxx
To Import duty		xxx		
To Carriage inward		xxx		
To Depreciation on machinery		xxx		
To Repairs to machinery		xxx		

Trading account is prepared for specific period to know the trading results of the business. It contains in a summarized form all the transactions occurring during a trading period which have direct relation to the goods dealt in by the business. It is prepared usually by merchandising concerns which purchase goods and sell the same during a particular accounting period. It is mainly prepared to ascertain the gross profit or gross loss. Gross profit or gross loss is the difference between actual sale proceeds and the cost of goods sold. (gross profit = excess of sale proceeds over cost of goods sold and gross loss = excess cost of goods sold over sale proceeds). The "cost of goods sold" includes the "purchase value" of such goods plus the "buying and bringing" expenses and the "conversion expenses of raw materials into saleable finished goods". Thus, "cost of goods" consists of:

(i) The opening stock of goods plus net purchases (*i.e.*, purchases less returns) less closing stock of such goods, and

(ii) All expenses of bringing the goods into saleable condition and also to the point of sale, *i.e.*, all manufacturing expenses, carriage, cartage, freight, duty, etc.

Preparation of Trading Account

Trading Account is a ledger account. Therefore, its form and construction conform to the rules of double entry principles of debit and credit.

As the trading account contains the results of operations over a period, the heading should be *"Trading account for the year (or any period) ended….."*.

A proforma of a Trading Account is given below:

Trading Account for the year ended 2014

Particulars	`	`	**Particulars**	`
To Opening stock		xxx	By Sales xxx	xxx
To Purchases	xxx		*Less:* Sales returns xxx	xxx
Less: Purchase returns	xxx	xxx	By Closing stock	xxx
To Direct expenses:			By Gross Loss c/d*	
Carriage inward		xxx		
Wages		xxx		
Freight		xxx		
Import duty		xxx		
Gas and fuel		xxx		
Royalty on production		xxx		
Factory expenses, etc.		xxx		
To Gross Profit c/d*		xxx		
transferred to Profit and Loss A/c				
		xxx		**xxx**

*Balancing figure will be either gross profit or gross loss.

Items Appearing on the Debit Side of Trading Account

1. **Opening Stock:** Stock on hand at the beginning of the year is called opening stock. This item is usually shown as the first item on the debit side of the trading account. The figure is available from the trial balance. It may include raw materials, work-in-progress and finished goods.
2. **Purchases:** It shows the gross amount of purchase made of the materials, and saleable goods. It includes both cash and credit purchases of goods made during the year which are meant for resale.
3. **Purchase Returns:** The purchase returns is a credit balance showing the return of goods to the suppliers. It should be subtracted from the total purchases to get the net purchases. Net purchases are shown in the trading account.

4. **Direct Expenses:** It refers to those expenses which are incurred for making the goods saleable. It may include factory or manufacturing expenses incurred on purchase of goods. Factory rent, wages, octroi, freight on purchases, manufacturing expenses, import duty, carriage inward, customs duty, dock dues, clearing charges, motive power, oil, grease and waste, packing charges, wages and salaries, cartage, royalty on production etc., these expenses are shown on the debit side of the trading account.

Items Appearing on the Credit Side of Trading Account

1. **Sales:** It is a credit balance indicating the total sales of goods made during the year. It includes both cash and credit sale of goods.
2. **Sales Return:** This is a debit balance, showing the total amount of goods returned by the customers. Sales returns should be subtracted from the total sales to find net sales which are shown on the credit side of trading account.
3. **Closing Stock:** It refers to the unsold goods which is lying in the godown at the end of the accounting year. Generally, the closing stock does not appear in the trial balance. It appears outside the trial balance. But when purchases are adjusted with opening and closing stocks, closing stocks appears as a debit balance in the trial balance. If it is given outside the trial balance, it will be shown on the credit side of trading account and also in the assets side of the balance sheet. If it is given in the trial balance, it will have to be shown only in assets side of the balance sheet. It may include raw materials, work-in-progress and finished goods.

Closing Entries in Respect of Trading Account

The following entries are passed in the journal to transfer the relevant ledger balances to the trading account.

(i) For transferring opening stock, net purchases and direct expenses to trading account:

Trading A/c	Dr.	xxx	
To Opening Stock A/c			xxx
To Purchases (Net) A/c			xxx
To Direct Expenses A/c			xxx

(ii) For transferring net sales and closing stock to trading account:

Sales (Net) A/c	Dr.	xxx	
Closing Stock A/c			xxx
To Trading A/c			xxx

(iii) (a) For gross profit:

Trading A/c	Dr.	xxx	
To Gross Profit A/c			xxx

(b) For gross loss:

Gross Loss A/c	Dr.	xxx	
To Trading A/c			xxx

Profit and Loss Account

According to Prof. Carter, "profit and loss account is an account into which all gains and losses are collected in order to ascertain the excess of gains where the losses or *vice versa*". Profit and loss account is prepared in order to calculate the net profit or net loss of the business. This account starts with the credit from the trading account in respect of gross profit (or debit if there is gross loss). From gross profit, operation and non-operating expenses are deducted and operating and non-operating income is added in order to calculate the net profit. When total of all the expenses is more than gross profit and other income, there remains a deficit and this is called net loss. The net profit or net loss ultimately transfers to capital account of the proprietor or to partners' capital accounts in case of partnership firm.

Preparation of Profit and Loss Account

As in the case of a trading account the profit and loss account is an account and hence, its form and construction conform to the rules of ledger account and principles of double entry system. Since the profit and loss account is prepared to show the net profit earned to net loss incurred during a particular period, it should be headed as under:

"Profit and Loss A/c of 2014 for the year ended"

The specimen proforma of a profit and loss account is given below:

Profit and Loss A/c of for the year ended 2014

Particulars	`	**Particulars**	`
To Gross Loss b/d	xx	By Gross Profit b/d	xx
To Management expenses:		By Interest received	
Office salaries	xx	By Discount received	xx
Rent, rates and taxes	xx	By Commission received	xx
Printing and stationery	xx	By Rent from tenants	xx
Postage and telegrams	xx	By Income from investments	xx
Telephone charges	xx	By Apprenticeship premium	xx
Legal charges	xx	By Interest on debentures	xx
Audit fees	xx	By Miscellaneous revenue receipts	xx
Insurance	xx	By Net Loss transferred to Capital A/c	xx
General expenses	xx		xx
Office lightning	xx		
To Financial expenses:			
Interest on capital	xx		
Interest on loans	xx		
Discount allowed	xx		
Discount on bills	xx		
To Selling and distribution expenses:			
Advertising	xx		
Traveler's salaries	xx		
Expenses and commission	xx		
Bad debts	xx		
Godown rent	xx		
Carriage outwards	xx		
Agent's commission	xx		
Upkeep of motor vans	xx		
Export expenses	xx		
To Depreciation and maintenance:			
Depreciation	xx		
Repairs and maintenance	xx		
To Extraordinary expenses:			**xxx**
Loss by fire (no covers by insurance)	xx		

Cash defalcations To Net Profit transferred to Capital A/c	xx xx		
	xxx		

Items Appearing on Debit Side of Profit and Loss A/c

The business expenses are divided into two types: direct expenses which are recorded in the Trading A/c and indirect expenses which are recorded in the debit side of Profit and Loss A/c. indirect expenses can be further divided into two varieties: (i) Operating expenses, and (ii) non-operating expenses.

(i) Operating Expenses: It refers to those expenses which are incurred in order to operate the business efficiently and smoothly. These include administration, selling, distribution, finance and maintenance expenses..

(ii) Non-operating Expenses: The expenses are not related to the operation of the business and include capital losses as loss on the sale of furniture, etc., writing off fictitious assets, as preliminary expenses, underwriting commission, etc., writing off intangible assets as goodwill, copyright, patents, etc.

Items Appearing Credit Side of Profit and Loss A/c

Gross profit is shown on the credit side of profit and loss account. Also other gains and incomes of the business are shown on the credit side. The other incomes are generally classified into two types, *i.e.*, (a) operating income, and (b) non-operating income.

(a) Operating Income: It refers to that portion of income which is earned for the operations of the business. Examples: interest, commission and discount earned, etc.

(b) Non-operating Income: This income is not earned from the routine operations of the business. Examples are profit on sale of any fixed assets, refund of tax.

Closing Entries for Profit and Loss A/c

(i) For transferring the various expenses to Profit and Loss A/c:

Profit and Loss A/c	Dr.	xxx	
To Various Expenses A/c			xxx

(ii) For transferring the various incomes again to Profit and Loss A/c:

Various Incomes Gains A/c	Dr.	xxx	
To Profit and Loss A/c			xxx

(iii) (a) For net profit:

Profit and loss A/c	Dr.	xxx	
To Capital A/c			xxx

(b) For net loss:

Capital A/c	Dr.	xxx	
To Profit and Loss A/c			xxx

Balance Sheet

It is a classified summary of balances remaining open in the general ledger after all the income and expenditure accounts have been closed off by transfer to trading and profit and loss account. It shows readily the financial position of the business at a given date by disclosing the amount of capital contributed and how the same has been invested and the values of assets and liabilities and their nature. The capital and liabilities of the business are shown on the left hand side and assets and other debit balances are shown in the right hand side. It is a statement containing all the unclosed balance "real" and "personal" accounts. Balance sheet is prepared with a view to measure the correct financial position of a business enterprise on a certain fixed date. It is a device for describing the financial position of a business in systematic standard form. By putting the financial position into such a form, it is possible to tell a complicated story of the enterprise in less time and space than if the same story were to be written as an extended narration: "Balance Sheet is a snapshot of the financial condition of the business". At one glance, the situation of the enterprise at certain date, can be understood. Therefore, it is rightly called as "Mirror" of the business, wherein the business can see its face, *i.e.*, its true position. An important thing to note about the balance sheet is that it always balances; that is to say; the total value of the assets is always equal to the total value of the claims or liabilities. In other words,

Assets = Liabilities + Capital (or)

Assets – Liabilities = Capital

In the other words of Fransis R. Stead, "Balance sheet is a screen picture of the financial position of a going business at a certain moment". According to R.N. Antony, "Balance sheet is a statement which reports the property values owned by the enterprise and the claims of the creditors and owners against the properties. It shows the status of the business as at a given moment of time, in so far as a counting of figures can show its status".

Classification of Assets and Liabilities

Assets

Assets represents everything which a business owns and has many values. Assets are always shown as debit balances. The various types of assets are:

(i) Fixed Assets: It refers to those assets which are held by way of equipment and not for the purpose of resale. They are of a permanent nature and it is by their help that the business is carried on. These are acquired for the purpose of creating production capacity, *e.g.*, plant and machinery, building, furniture, fixtures and motor, vehicles, etc. The assets may be further subdivided into: (a) tangible assets, and (b) intangible assets.

- **(a) Tangible Assets:** It refers to those assets which can be seen, touched and have volume such as machinery, land and building, furniture, etc.
- **(b) Intangible Assets:** These assets do not have physical existence. Goodwill, patents, trademarks and copyrights are examples of intangible assets. Though they are intangible, they are fixed assets as they are represented by certain values. Further, patents, trademarks and copy rights etc. are all useful for earning revenues.

(ii) Current Assets: Current assets are those assets which are to be converted into cash within one year or during the normal operating cycle of the business, *e.g.*, cash, bank, marketable securities, debtors, bills receivable and inventory which consists of debtors materials, work-in-progress and finished goods. These are also called floating assets because their value is constantly floating, *i.e.*, changing from one form to another as given in the following chart.

(iii) Liquid Assets: Liquid assets are readily convertible into cash at short notice with little or no risk of loss. Conversion of inventory into cash will take more time and hence it is not a liquid asset. Example: cash, bank, marketable securities, debtors and bills receivable.

(iv) Fictitious Assets: As the name implies such "assets" are to really assets. Only for the sake of convenience, the amount is shown as an asset in the balance sheet. No amount can be realized or further benefit derived from the expenditure concerned. These assets are shown on the assets side of balance sheet till they are fully written off. It is prudent to write off these assets to profit and loss account as early as possible. Examples would be: Preliminary expenses, Expenses on issue of share and debentures, Discount on issue of shares and debentures and Debit balance of Profit and Loss A/c.

(v) Contingent Assets: Contingent asset is one, the existence of which depends upon the happening of a certain event which may or may not take place. Examples would be (a) claim for income tax refund, (b) uncalled share capital of a public limited company (c) claim by the firm for infringement of trade marks or patent or copy right, etc., by others. These assets need not be shown in the balance sheet. They are usually shown as a footnote to the balance sheet.

(vi) Wasting Assets: The fixed assets which have a limited useful life and which, by nature, depreciate rapidly are termed as wasting assets. A wasting asset is as asset that diminishes in value by reason of and commensurately with the extraction or removal of a natural product. As soon as, say all the oil in an oil well has been extracted, the oil well becomes valueless. Mines and quarries have the same characteristics.

Liabilities

All that the business owes to others are called liabilities. It also includes proprietor's capital. They are known as credit balances in the ledger. Liability is a claim by an outsider on the assets of the business. Liabilities may be classified into four categories:

(i) Proprietor's capital or net worth: Proprietor's capital is the original fund with which he entered a business. Later on, he may introduce further amounts towards capital and he may withdraw some amounts from the business. Net worth means the amount of capital outstanding on the particular date plus any profits retained in the business. The total amount belongs to the proprietor. This is shown on the liabilities side of the balance sheet as it is payable by the business to the proprietor.

(ii) Long-term liabilities: The liabilities which are repayable after a long period of time are known as fixed liabilities, *i.e.*, they do no become due for payment in the ordinary course of the business within a relatively short period, *e.g.*, long-term loans and debentures. These may be secured or unsecured. But generally, they are secured.

(iii) Current liabilities: It refers to those liabilities which are repayable within one year or during the normal operating cycle of the business by the use of the existing resources of current assets or by the creation of similar current liabilities, *e.g.*, trade creditors, bills payable, accrued expenses, bank overdraft, provision for taxation, proposed dividend, etc.

(iv) Contingent liabilities: Contingent liability will become an actual liability only on the happening of a certain event which may or may not happen. These are:

(a) Bills discounted and endorsed which may be dishonoured.
(b) Claim by others which has been disputed by the firm or pending in the court of law.
(c) Unpaid call amounts on investments.

These are to be disclosed by way of not to the balance sheet.

Grouping and Marshalling of Assets and Liabilities

A balance sheet is usually prepared in the form of a statement, with assets on the right hand side and liabilities and capital on the left-hand side. The component items of a balance sheet should be arranged in an orderly manner and in a sequence that should be adhered to year-by-year. Such an arrangement of the items in a balance sheet is known as 'Marshalling'. There are two ways in which the assets and liabilities can be arranged in balance sheet. They are: (a) order of performance, and (b) order of liquidity.

The first method is commonly used by companies, whereas the second one is popular among sole traders and partnership firms. However, in case of certain concerns, such as banking companies, insurance companies, railway companies, other joint stock companies, etc., form of balance sheet is prescribed by the law.

(i) Proforma of balance sheet in the order of permanency:

Balance Sheet of as on .....

Liabilities		`	**Assets**	`
Capital:			***Fixed assets:***	
Add: Net profit	xx		Goodwill	xx
Add: Interest on capital	xx		Land and building	xx
Less: Drawings	xx		Loose tools	xx
Less: Interest on drawings	xx		Furniture and fixtures	xx
Less: Loss if any	xx	xx	Vehicles	xx
Long-term liabilities:			Patents	xx
Loan on mortgage		xx	Trademarks	xx
Bank loan		xx	Long-term loans (advances)	xx
Current liabilities:			Investments	xx
Sundry creditors		xx	Current assets	xx
Bills payable		xx	Closing stock	xx
Bank overdraft		xx	Sundry debtors	xx
Creditors for outstanding expenses		xx	Bills receivable	xx
Income received in advance		xx	Prepaid expenses	xx
			Accrued income	xx
			Cash at bank	xx
			Cash in hand	
			Fictitious assets:	
			Preliminary expenses	xx
			Advertising expenses	xx
			Underwriting commission	xx
			Discount on issue of shares	xx
			Discount on issue of debentures	xx
		xxx		**xxx**

(ii) Proforma of balance sheet in the order of liquidity:

If the liquid principle is followed then the sequence of presentation of items will be as under

Balance Sheet of as on .....

Liabilities	`	**Assets**	`
Current liabilities	xxx	Current assets	xxx
Fixed or long-term liabilities	xxx	Investments	xxx
Liabilities to owner or owner's funds	xxx	Fixed assets	xxx
		Fictitious assets	xxx
	xxxx		**xxxx**

ADJUSTMENTS

Final accounts are prepared for a completed period. It must be kept in mind that expenses and incomes for the full accounting period are to be taken while preparing final accounts. If an expense has been incurred but not paid during the period, a liability for the unpaid amount should be created before finding out the operating results and financial position of a concern. In order to prepare the final accounts on mercantile system of accountancy, all expenses and incomes relating to the period whether incurred or not, received or not should be brought into account. For doing this, a concern is required to pass certain entries at the end of the year to adjust the various items of incomes and expenses. Such entries are called adjusting entries. The various adjustments required are given below:

(i) Closing Stock: It refers to the value of unsold goods lying in stock at the end of the accounting period. It should be valued either at cost price or market whichever is lower. It consists of three items, *i.e.*, raw materials, work-in-progress and finished goods.

The adjustments entry is:

Closing Stock A/c	Dr.	xxx	
To Trading A/c			xxx

The value of closing stock will appear on the assets side of balance sheet and on the credit side trading account.

(ii) Outstanding Expenses: These are certain expenses which relate to a particular accounting period but they are not paid in that accounting period due to certain reason, *i.e.*, all expenses which are due for payment in one accounting year but actually paid in future accounting years or payment on which it postpones are all outstanding or unpaid expenses. At the end of the accounting year, all such expenses must be brought into books, otherwise the profit will be overstated.

The adjustment entry is:

Expenses A/c	Dr.	xxx	
To Expenses Outstanding A/c			xxx

Expenses outstanding are added to the respective expenses accounts in trading or profit and loss account and also shown on the liabilities side of the balance sheet. next year, the expenses outstanding account will be transferred to the expenses account. If the Outstanding Expenses A/c appears in the trial balance, it means that the adjustments has already has bee made and hence nothing has to be done in trading or profit and loss account. But the liability already appearing in the trial balance should be shown in the balance sheet.

(iii) Prepaid Expenses: Prepaid expenses are those expenses which have been paid in advance but relating to the future accounting period. These are also called the unexpired expenses.

The adjustment entry is:

Prepaid Expenses A/c	Dr.	xxx	
To Expenses A/c			xxx

Prepaid Expenses Account is shown on the asset side of balance sheet and Expense Account is shown as a deduction from the respective expense account in trading and profit and loss account. Prepaid expenses appear in the trial balance. It means that the adjustments has already been made nothing is to be done in trading and profit and loss account. But the prepaid expense will appear as an asset in the balance sheet. Generally, insurance, taxes, telephone subscription, and etc., are paid in advance thus, requiring adjustments.

(iv) Accrued Income: Outstanding or accrued income is the income which has been earned but not received during the accounting period.

The adjustment entry is:

Accrued Income A/c	Dr.	xxx	
To Income A/c			xxx

Accrued income is shown on the asset side of balance sheet and it is added to the respective income account in profit and loss Account credit side. No adjustment is required in the profit and loss account if Accrued Income A/c appears in the trial balance, but such an account must be shown as an asset in balance sheet.

(v) Income Received in Advance: Many a time, traders receive money during a particular trading period for the work to be done in future period. Thus, without rendering any service, they receive income.

Such an income is known as income received in advance, *i.e.*, the income received but not earned during the accounting period.

The adjustment entry is:

Income A/c	Dr.	xxx	
To Income Received in Advance A/c			xxx

Income received in advance is shown as deduction from the respective income in profit and loss account is shown on the liabilities side of the balance sheet. No treatment is required in the profit and loss account if income received in advance account appears in the trial balance. But such account must be shown as a liability in the balance sheet.

(vi) Depreciation of Assets: Depreciations is a permanent decrease or reduction in the value of a fixed asset. The asset may reduce in value due to its constant use or even sometimes due to its non-use, *i.e.*, merely by passage of time. Whatever may be the cause for decline, the fact is that such reduction is a loss to the business. Therefore, it must written off from the asset so as to arrive at the true results of the business.

The adjustment entry for depreciation assets is:

Depreciation A/c	Dr.	xxx	
To Asset A/c			xxx

Depreciation is shown on the debit side of profit and loss account and is deducted from the asset in the balance sheet. Depreciation Account (Dr.) appearing in the trial balance has to be debited to profit and loss account and no deduction from asset balance is required because this has already been done.

(vii) Interest on Capital: In order to see the real profitability of the business, it is desirable to charge interest on capital treating it as a business expenses. In order to bring this interest books, the following adjustment entry is passed:

Interest on capital A/c	Dr.	xxx	
To Capital A/c			xxx

Interest on capital is shown on the debit side of profit and loss account is added to the capital on the liabilities side of balance sheet. Interest on account appearing in the trial balance is only to be shown in profit and loss account inside and it is not required to be included in capital account because such it has been already included.

(viii) Interest on Drawings: When the proprietor withdraws money from the business for personal use almost to temporary loan by the business to the proprietor. This should be treated on par with loan to an outsider from whom interest in receivable by the business. Therefore, the business charges the proprietor with interest on amounts drawn by him. Thus, interest on drawings is a business income. The following adjustment entry is to be passed on bring this item into account

Capital A/c	Dr.	xxx	
To Interest on Drawings A/c			xxx

Interest on capital is shown on the credit side of profit and loss account and it is deducted from the capital account on the liabilities side of balance sheet. Interest on Drawings Account appearing in the trial balance has to be transferred to profit and loss account credit side alone.

(ix) Bad Debts: When a claim against a debtor becomes irrecoverable, it is called bad debt. If a person files a petition in bankruptcy, his creditors generally write-off the irrecoverable amount due as a bad debt. The entry in the books of the creditor is:

Bad Debts A/c	Dr.	xxx	
To Debtor's A/c			xxx

Bad debts is shown on the debit side of profit and loss account also deducted from debtors in the balance sheet. Alternatively, bad debts amount is closed by transfer to the debit of provision for bad and doubtful debts.

Provision for Doubtful Debts A/c	Dr.	xxx	
To Bad Debts A/c			xxx

If the bad debt amount is recovered in future years, the cash is debited and Bad Debts Recovered A/c is credited in that year. The balance in the later account is closed by transferring it to the credit of profit and loss account as revenue in that year. If the bad debt appears in the trial balance, it means that adjustments has already been made and this will appear only in the debit side of profit and loss account. It need not be reduced from debtors in the balance sheet.

(x) Provision for Bad and Doubtful Debts: Sometimes, a merchant feels that there are certain debtors from whom the money may or may not be realizable. As there is a possibility of anticipated losses and in order to provide for such loss in the accounts, a provision or doubtful debts is required to be made. It generally a percentage on the debtors and the percentage is fixed on the basis of past experience. The following adjusting entry will be made in order to bring the provision for doubtful debts into the books:

Profit and Loss A/c	Dr.	xxx	
To Provision for Doubtful Debts A/c			xxx

In this case also the amount of 'provision required' should be shown as a deduction from the existing debtors on the assets side of the balance sheet. The object of making the provision is to show the debtors on the balance sheet at a realistic value. Sometimes, bad debts may be written off during the year. Some additional bad debts are to be written off at the time of finalizing the accounts. There may be existing provision for doubtful debtors (old provision). Provision is required on the debtors as on the closing date. The following is the usual way of dealing with all these items.

Profit and Loss A/c (debit side)	
Bad debts (as per trial balance)	xxx
Add: Bad debts (as per adjustments)	xxx
Add: New provision required	xxx
	xxx
Less: Existing provision (given in trial balance)	xxx
Net debit to Profit and Loss Account	xxx

The new provision required is to be reduced from the debtors in the balance sheet along with additional bad debts as per adjustments.

(xi) Provision for Discount on Debtors: The provision for discount on debtors is calculated at a certain percentage on good debtors. No discount is allowed on doubtful debtors. This is to provide a certain amount for allowing discount to customers for prompt payment. The adjustment entry is:

Profit and Loss A/c	Dr.	xxx	
To Provision for Discount on Debtors			xxx

The provision for discount on debtors is shown as a deduction from good debtors on the asset side of Balance Sheet and is debited to Profit and Loss Account.

(xii) Provision for Discount on Creditors: The creditors may offer some discount for prompt payment by the firm. This is calculated at a certain percentage on sundry creditors. The adjustment entry is

Provision for Discount on Creditors A/c	Dr.	xxx	
To Profit and Loss A/c			xxx

The provision for discount on creditors is shown as a deduction from sundry creditors on the liabilities of Balance Sheet and is credited to Profit and Loss A/c.

(xiii) Loss of Stock by Accident, Fire, etc.: Stock of goods destroyed due to abnormal causes must be treated as abnormal loss. If there is no insurance the entire stock lost should be treated as abnormal loss.

The entry is:

Abnormal Loss A/c	Dr.	xxx	
To Trading A/c			xxx

Since there will be no recovery, the abnormal loss has to be closed.

Profit and Loss A/c	Dr.	xxx	
To Abnormal Loss A/c			xxx

If there is insurance, amount recoverable from the insurance company has to be debited to insurance company and the balance of abnormal loss is written off to Profit and Loss A/c.

Profit and Loss A/c	Dr.	xxx	
Insurance Company A/c	Dr.	xxx	
To Abnormal Loss A/c			xxx

Illustration 1

Prepare Trading Account of Archana for the year ending 30-12-2014 from the following information:

Particulars	`
Opening stock	80,000
Purchases	8,60,000
Freight inward	52,000
Wages	24,000
Sales	14,40,000
Purchase returns	10,000
Sales returns	3,16,000
Sales returns	1,00,000
Import duty	30,000

Solution

Dr. Trading Account of Archana for the year ended 30-12-2014 Cr.

To Opening stock		80,000	By Sales	14,40,000	11,24,000
To Purchases	8,60,000		*Less:* Sales returns	3,16,000	1,00,000
Less: Purchase returns	10,000	8,50,000	By Closing stock		
To Freight inward		52,000			
To Wages		24,000			
To Import duty		30,000			
To Gross Profit c/d		1,88,000			
		12,40,000			**12,40,000**

Illustration 2

From the following particulars, prepare manufacturing account for the year ended 31st March, 2014.

Raw materials (1-4-2013)	33,000
Work-in-progress (1-4-2013)	17,000
Finished goods (1-4-2013)	27,000
Purchases:	
Raw materials	1,00,000
Finished goods	10,000
Carriage inwards:	
on Raw materials	2,500
on Finished goods	100
Purchases returns:	
on Raw materials	5,000
on Finished goods	200
Freight and octroi:	
on Purchases of raw materials	500
on Purchases of finished goods	100
Sales:	
Sales of scrap	150
Sales of finished goods	3,00,000
Rent (3/4th for factory)	4,000
Insurance (20%for factory)	1,000
Productive wages	6000
Repairs to building (40% on office building)	1,000
Depreciation on machinery	2,100
Factory supervisor’s salary	2,400
Manager’s salary (1/4th for factory)	5,000
Raw materials (31-3-2014)	22,000
Work-in-progress (31-3-2014)	13,500
Finished goods (31-3-2014)	40,000

Solution

Dr. **Manufacturing Account for the year ended 31-3-2014** **Cr.**

Particulars	`	`	**Particulars**	`	`
To Opening stock:			By Sales of scrap		150
Raw materials (1-4-2008)	33,000				1,27,900
Work-in-progress (1-4-2008)	17,000	50,000			
To Purchases of:			By Cost of production		35,500
Raw materials	1,00,000		(Trfd to Trading A/c (b/f)		
Less: Purchases returns	5,000	95,000	By Closing stock:		
To Carriage inwards		2,500	Raw materials	22,000	
To Freight and octroi		500	Work-in-progress	13,500	
To Rent (3/4th for factory)		4,000			
To Insurance (20% for factory)		1,000			
To Productive wages		1,000			
To Repairs to building (60%)		6,000			
To Dep. on machinery		2,100			
To Factory supervisor's salary		2,400			
To Manager's salary(1/4th)		1,250			
		1,63,550			**1,63,550**

Illustration 3

The following are the balances in the Ledger of Mr. Sherif for the year ended 31st March, 2014.

Particulars	`
Opening stock:	
Raw materials	20,000
Work-in-progress	3,000
Finished goods	10,800
Purchase of raw materials	50,000
Sales	2,40,000
Fuel and coal	1,000
Wages	32,000
Factory expenses	40,000
Office expenses	30,000
Depreciation on plant and machinery	3,000
Closing stock:	
Raw materials	2,000
Work-in-progress	4,000
Finished goods	8,000

Prepare Manufacturing and Trading accounts for the year ended 31st March, 2014.

Solution

Manufacturing and Trading Account of Mr. Sherif for the year ended 31.3.2014

Particulars	`	Particulars	`
To Opening work-in-progress	3,000	By Closing work-in-progress	4,000
To Cost of materials consumed		By Cost of goods manufactured	1,25,000
Opening stock 20,000		(transferred to Trading A/c) (b/f)	
Add: Purchases <u>50,000</u>			
70,000			
Less: Closing stock <u>20,000</u>	50,000		
To Wages	32,000		
To Fuel and coal	1,000		
To Factory expenses	40,000		
To Depreciation on Plant & Mach	3,000		
	1,29,000		**1,29,000**
To Opening stock of finished goods	10,800	By Sales	2,40,000
To Cost of goods manufactured	1,25,000	By Closing stock of finished goods	8,000
To Gross Profit c/d	1,12,200		
	2,48,000		**2,48,000**

Comprehensive Illustrations

Illustration 4

The following are the ledger balances extracted from the books of WEIFA.

WEIFA capital	50,000	Sales	3,01,000
Bank overdraft	8,400	Return inwards	5,000
Furniture	5,200	Discount (cr)	800
Business premises	40,000	Taxes and insurance	4,000
Creditors	26,600	General expenses	8,000
Opening stock	44,000	Salaries	18,000
Debtors	36,000	Commission allowed	4,400
Rent from tenants	2,000	Carriage on purchases	3,600
Purchase	2,20,000	Provision for doubtful debts	1,000
		Bad debts written off	1,600

Adjustments:

(i) Stock on hand on 31-12-14 was estimated at ` 4,0120.

(ii) Write-off depreciation on business premises ` 600 and furniture ` 520.

(iii) Make a provision of 5% on debtors for bad and doubtful debts.

(iv) Allow interest on Capital at 5% and carry forward ` 1,400 for unexpired insurance.

Prepare Final Accounts for the year ended 31-12-14.

Solution

In the Books of WEIFA
Trading and Profit and Loss Account for the year ended 31-12-14

Particulars	`	`	Particulars	`	`
To Opening stock		44,000	By Sales	3,01,000	2,96,000
To Purchases		2,20,000	*Less:* Sales returns	5,000	
To Carriage on purchases		3,600	By Closing stock		40,120
To Gross Profit c/d		68,520			
		3,36,120			**3,36,120**
To Taxes and insurance	4,000		By Gross Profit b/d		68,520
Less: Prepaid	1,400		By Rent		2,000
To General expenses		2,600	By Discount		800
To Salaries		8,000			
To Commission		18,000			
To Bad debts	1,600	4,400			
Add: New provision for doubtful debts	1,800				
	3400				
Less: Existing provision	1,000				
To Depreciation:		2,400			
on Business premises	600				
on Furniture	520				
To Interest on capital		1,120			
To Net Profit transferred		2,500			
to Capital A/c		32,300			
		71,320			**71,320**

Balance Sheet of WEIFA as at 31-12-2014

Liabilities	`	`	Assets	`	`
Creditors		26,600	Debtors	36,000	
Bank overdraft		8,400	*Less:* Prov. for B/D	1,800	34,200
Capital	50,000		Stock		40,120
Add: Net profit	32,300		Prepaid insurance	5,200	1,400
	85,300		Furniture	520	4,680
Add: Interest on capital	2,500	84,800	*Less:* Depreciation		
			Business premises	40,000	
			Less: Depreciation	600	39,400
		1,19,800			**1,19,800**

Illustration 5

Prepare Trading, Profit and Loss Account and Balance Sheet from the following Trial Balance of Mr. Madan.

Debit Balances	`	Credit Balances	`
Sundry debtors	92,000	Madan's capital	70,000
Plant and machinery	2,000	Purchase returns Sales	2,600
Interest	430	Sundry creditors	2,50,000
Rent, rates, taxes & insurance	5,600	Bank overdraft	60,000
Conveyance charges	1,320		20,000
Wages	7,000		
Sales returns	5,400		
Purchases	1,50,000		
Opening stock	60,000		
Madan's drawings	22,000		
Trade expenses	1,350		
Salaries	11,200		
Advertising	840		
Discount	600		
Bad debts	800		
Business premises	12,000		
Furniture and fixtures	10,000		
Cash in hand	2,060		
	4,02,600		**4,02,600**

Adjustments:

(i) Stock on hand 31-12-09 ` 90,000.

(ii) Provide depreciation on premises at 2.5%, plant and machinery at 7.5% and furniture and fixtures at 10%.

(iii) Write off ` 800 as further bad debts.

(iv) Provide for doubtful debts at 5% on sundry debtors.

(v) Outstanding rent was ` 500 and outstanding wages were ` 400.

(vi) Prepaid insurance ` 300 and prepaid salaries ` 700.

Solution

Dr. Trading and Profit and Loss A/c for the year ended 31-12-14 Cr.

Particulars	`	`	**Particulars**	`	`
To Opening stock		60,000	By Sales	2,50,000	
To Purchases	1,50,000		*Less:* Sales returns	5,400	2,44,600
Less: Purchases returns	2,600	1,47,40	By Closing stock		9,000
To Wages	7,000				
Add: Outstanding	400	7,400			
To Gross Profit c/d		1,19,800			
		3,34,600			**3,34,600**
To Trade expenses		1,350	By Gross Profit b/d		1,19,800
To Salaries	11,200				
Less: Prepaid	700	10,500			
To Conveyance charges		1,320			
To Advertising		840			
To Rent, rates, taxes and insurance	5,600				
Add: Rent outstanding	500	5,100			
	6,100				
Less: Prepaid insurance	300	5,800			
To Discount		600			
To Interest		430			
To Bad debts	800				
Add: Additional bad debts	800				
Add: New provision for bad debts	4,560	6,160			
To Depreciation:					
Premises	300				
Plant and machinery	1,500				
Furniture and fixtures	4,560	2,800			
To Net Profit transferred to Capital A/c		90,000			
		1,19,800			**1,19,800**

Balance Sheet of Mr. Madan as at 31-12-14

Liabilities	`	`	**Assets**	`	`
Sundry creditors		60,000	Cash in hand		2,060
Bank overdraft		20,000	Sundry debtors	92,000	
Outstanding Rent	500		*Less:* Bad debts	800	
Add: Wages	400	900		91,200	
Capital	70,000		*Less:* Provision for BD	4,560	86,640
Less: Drawings	22,000				

	48,000		Stock		90,000
Add: Net profit	90,000	1,38,000	Prepaid insurance		300
			Salaries		700
			Plant and machinery	20,000	
			Less: Depreciation	1,500	18,500
			Business premises	12,000	
			Less: Depreciation	300	11,700
			Furniture and fixtures	10,000	9,000
			Less: Depreciation	1,000	
		2,18,900			**2,18,900**

Illustration 6

From the following trial balance extracted from the books of Kamalnath, prepare Trading and Profit and Loss Account and Balance Sheet for the year ended 31-12-14.

Debit Balances	₹	Credit Balances	₹
Cash at bank	2,610	Creditors	4,700
Book debts	11,070	Discounts	150
Salaries	4,950	Creditors for expenses	400
Carriage inwards	1,450	Returns outwards	2,520
Carriage outwards	1,590	Sales	80,410
Bad debts	1,310	Capital	40,000
Office expenses	5,100		
Purchases	67,350		
Return inwards	1,590		
Furniture	1,500		
Stock	14,360		
Insurance	3,300		
Depreciation	1,200		
Freehold property	10,800		
	1,28,180		**1,28,180**

Adjustments:

(i) Make provision for doubtful debts at 5%.

(ii) Calculate discount on creditors @ 5%.

(iii) Office expenses include stationery purchased ₹ 800.

(iv) Carriage inwards includes carriage paid on purchase of furniture ₹ 50.

(v) Outstanding salaries ₹ 150.

(vi) Prepaid insurance ₹ 300

(vii) Stock on hand ₹ 10,700 (including stationery stock ₹ 200)

Solution

Trading and Profit and Loss Account of Kamalnath for the year ended 31-12-14

Particulars	`	`	Particulars	`	`
To Opening stock		14,360	By Sales	80,140	7,880
To Purchases	67,350		*Less:* Sales return	1,590	10,500
Less: Purchases returns	2,520	64,830	By Closing stock	10,700	
To Carriage inwards	1,450		*Less:* Stock of stationery	200	
Less: Paid for furniture	50				
To Gross Profit c/d		1,400			
		8,730			
		89,320			**89,320**
To Salaries	4,950	5,100	By Gross profit b/d		8,730
Add: Outstanding	150		By Discount		150
To Insurance	3,300		By Provision for discount on creditors		94
Less: Prepaid	300	3,000	By Net Loss (transferred to Capital A/c		8,679
To Office expenses	5,100				
Less: Stationery purchased	800	4,300			
To Bad debts	1,310				
Add: New provision for bad debts	553	1,863			
To Carriage outwards		1,590			
To Stationary	800	600			
Less: Stock	200				
To Depreciation on Property		1,200			
		17,653			**17,653**

Balance Sheet of Kamalnath as at 31-12-14

Liabilities	`	`	Assets	`	`
Sundry Creditors:			Cash at bank		2,610
Trade Creditors:	4,700		Book Debts	11,070	
Less: Provision for discount	94	4,606	*Less:* Provision for BD	553	10,517
Outstanding creditors: for expenses	400		Stock of goods		10,500
Add: Salary	150	550	Stock of stationery		200
Capital	40,000		Prepaid insurance		300
Less: Net loss	8,679	31,321	Furniture and fixtures (1,500 + 50)		1,550
			Freehold property		10,800
		36,477			**36,477**

Illustration 7

The following are the ledger balances extracted from the books of Ramani as on 31-12-14.

Particulars	`	Particulars	`
Debit balances:		Credit balances:	
Drawings	3,000	Sales	24,000
Goodwill	6,000	Provision for bad and doubtful debts	900
Land and buildings	12,000	Provision for discount on debtors	342
Plant and machinery	8,000	Loan at 6%	4,000
Loose tools	600	Capital	40,000
Bills receivable	1,600	Sundry creditors	8,000
Stock, 1st Jan., 1996	8,000	Purchase returns	500
Purchases	10,200	Discount received	300
Wages	4,000	Commission received	400
Carriage inwards	200	Bills payable	2,278
Carriage outwards	80		
Coal, gas, and coke	1,160		
Sales return	400		
Furniture and fixtures	240		
General expenses	1,050		
Provision for discount on	320		
Creditors	120		
Interest on loan	1,000		
Salaries	560		
Rent, rates and taxes	300		
Discount allowed	5,000		
Cash at bank	80		
Cash in hand	9,000		
Sundry debtors	360		
Repairs	110		
Printing and stationery	640		
Bad debts	6,000		
Advertisements: (special)	700		
(normal)			
	80,720		**80,720**

Adjustments:

(i) Closing stock on 31-12-14 amounted to ` 15,654.

(ii) Depreciate plant and machinery at 5%, loose tools at 15% and furniture and fixtures at 20%.

(iii) Provide for bad and doubtful debts at 5% and for discount on debtors and creditors at 2%.

(iv) Outstanding wages ` 200 and rent, rates and taxes ` 100.

(v) Write of one-third of advertisement (special)

(vi) Interest on loan has been paid for six months only.

(vii) A bill for ` 1,000 included in bills receivable has been dishonoured.

(viii) The manager is entitled to a commission of 5% on net profit after charging such commission.

Prepare final accounts for the year ended 31-12-14.

Solution

Trading and Profit and Loss Account of Kamalnath for the year Ending 31-12-14

To Opening stock		8,000	By Sales	2,400	
To Purchase	10,200		*Less:* Returns	400	23,600
Less: Returns	500	9,700	By Closing stock		15,654
To Carriage inwards		200			
To Wages	4,000				
Add: Outstanding	200	4,200			
To Coal, agas & coke		1,160			
To Gross Profit c/d		15,994			
		39,254			**39,254**
To Carriage outwards		80	By Gross Profit b/d		15,994
To Salaries		560	By Commission		400
To Rent, rates and taxes	300		By Discount received	300	
Add: Outstanding	100	400	*Add:* New provision	140	
To Repairs		110	*Less:* Existing provision	460	320
To Printing and stationery		640			
To Advertisement (normal)		700			
To General expenses		1,050			
To Interest on loan	120				
Add: Outstanding	120	1,640			
To Bad debts	640	1050			
Add: New provision for bad debts	500	240			
Less: Existing provision for bad debts	1,140	240			
To Discount allowed	300	148			
Add: New provision for discount	190				
Less: Existing provision for discount	342				
To Advertisement (Special) written off (6000 × 13)		2,000			
To Depreciation on:					
Plant and machinery	400				

Loose tools	90	538			
Furniture and fixtures	48				
To Manager's commission		448			
To Net Profit transferred to Capital A/c		8,960			
		16,534			**16,534**

Balance Sheet of Ramani as on 31-12-2014

Particulars	`	`	**Particulars**	`	`
Sundry creditors	8,000		Cash in hand		80
Less: Provision for			Cash at bank	1,600	5,000
discount	160	7,840	Bills receivable	1,000	600
6% loan	4,000		*Less:* Dishonoured	9,000	
Add: Interest			Sundry debtors	1,000	
outstanding	120	4,120	*Add:* B/R dishonoured	10,000	
Bills payable		2,278	*Less:* Provision for BD	500	
Outstanding expenses:			*Less:* Provision for	9,500	
Wages	448		Discount	190	9,310
Rent, rates & taxes	300	748	Stock		15,654
Manager's commission	40,000		Loose tools	600	
Capital opening	8,960		*Less:* Depreciation	90	510
Add: Net profit	48,960		Furniture and fixtures	240	
Less: Drawings	3,000	45,960	*Less:* Depreciation	48	192
			Plant and machinery	8,000	
			Less: Depreciation	400	7,600
			Land and buildings		12,000
			Advertisement (special)	6,000	
			Less: Written off	2,000	4,000
			Goodwill		6,000
		60,946			**60,946**

Illustration 8

From the following trial balance of Sri Narayanan, you are required to prepare a trading and Profit & Loss A/c for the year ended 31st December, 2014 and a balance sheet as on that date.

Debit Balances	`	**Credit Balances**	`
Stock on 1st Jan., 2014	70,000	Capital	2,00,000
Plant and machinery	50,000	Wages outstanding	4,000
Rent	3,000	Sales	5,00,000
Depreciation on plant and machinery	5,000	Creditors	45,000
Drawings	40,000	Bills payable	16,000
Wages	20,000	Discount (CR.)	12,000

Income tax	2,000	Bank overdraft	9,000
Salary for 11 months	11,000	Commission (Cr.)	8,000
Cash	5,000	Purchase returns	5,000
Buildings	1,60,000		
Depreciation on buildings	8,000		
Purchases	3,00,000		
Debtors	80,000		
Bills receivable	30,000		
Discount (Dr.)	2,000		
Carriage inwards	4,000		
Bad debts	6,000		
Sales returns	3,000		
	7,99,000		**7,99,000**

Adjustments:

(i) Stock on 31st Dec., 2014 was ` 96,000

(ii) Stock destroyed by fire was ` 6,000 and the insurance company accepted a claim for ` 3,600.

(iii) ` 1,600 paid as rent of the office was debited to landlord account and was included in the list of debtors.

(iv) Goods invoiced ` 10,000 was sent to customers on sale or return basis on 28th December, 2014, the customer still having the right to return the goods. The rate of gross profit was 1/5 a of sale.

(v) Write off further bad debts ` 4,000 and maintain 5% provision for bad debts on debtors.

(vi) One month's salary was outstanding.

Solution

Trading and Profit and Loss A/c of Sri Narayanan for the year Ended 31-12-14

Particulars	`	`	Particulars	`	`
To Opening stock		70,000	By Sales	5,00,000	
To Purchase	3,00,000		*Less:* Returns	3,000	
Less: Returns	5,000	2,95,000		4,97,000	
To Carriage inwards		4,000	*Less:* Goods sent on		
To Wages		20,000	sale or return	10,000	4,87,000
To Gross Profit c/d		2,08,000	By Closing stock	96,000	
			Add: Stock with		
			Customers	8,000	
			Add: Stock destroyed	6,000	1,10,000
		5,97,000			**5.97, 000**
To Salaries	11,000		By Gross Profit b/d		2,08,000
Add: Outstanding	1,000	12,000	By Discount		12,000
To Rent	3,000		By Commission		8,000
Add: Debited to landlord	1,600	4,600			
To Discount		2,000			
To Bad debts	6,000				

Add: Further bad debts	4,000				
Add: New provision for bad debts	3,220	13,220			
To Depreciation on:					
Plant and machinery	5,000				
Buildings	8,000	13,000			
To Loss on stock destroyed		2,400			
To Net Profit transferred To Capital A/c		1,80,750			
		22,800			**22,800**

Balance Sheet of Sri. Narayanan as on 31-12-2014

Particulars	`	`	Particulars	`	`
Bills payable		16,000	Cash		5,000
Bank overdraft		9,000	Bills receivable		30,000
Creditors		45,000	Debtors	80,000	
Outstanding expenses:			*Less:* Rent included	1,600	
Salary	1,000		*Less:* Goods on sale or	78,400	
Wages	4,000	5,000	return		
Capital	2,00,000		*Less:* Bad debts	10,000	
Less: Drawing	40,000		Less: Provision for BD	68,400	61,180
Less: Income tax	2,000		Insurance company	4,000	
Add: Net profit	1,58,000	3,38,780	Stock	64,400	3,600
			Stock with customers	3,220	96,000
			On sale or return		8,000
			Plant and machinery		50,000
			Buildings		1,60,000
		4,13,780			**4,13,780**

Illustration 9

The following is the schedule of balance on 31-3-2014 extracted from the books of Manikandan.

Particulars	`	Particulars	`
Cash in hand	22,800	Capital account	3,24,000
Cash at bank	5,200	Discount received from	3,200
Sundry debtors	1,72,000	creditors	5,200
Stock as on 1-4-13	1,24,000	Purchase returns	4,60,000
Furniture and fixtures	42,800	Sales	6,000
Office equipments	32,000	Provision for bad debts	60,000
Buildings	1,20,000	Loan from Gopu	1,06,000
Motor car	40,000	Sundry creditors	
Purchases	2,80,000		
Sales returns	8,400		
Salaries	22,000		

Rent for godown	11,000		
Interest on loan from Gopu	5,400		
Rates and taxes	4,200		
Discount allowed to debtors	4,800		
Freight on purchases	2,400		
Carriage outwards	4,000		
Drawings	24,000		
Printing and stationery	3,600		
Electric charges	4,400		
Insurance premium	11,000		
General office expenses	6,000		
Bad debts	4,000		
Bank charges	3,200		
Motor car expenses	7,200		
	9,64,400		**9,64,400**

Prepare trading and profit and loss account for the year ended 31-3-2014 and the balance sheet as at that date after making provision for the following:

(i) Value stock on 31-3-2014 was ` 88,000.

(ii) One month's rent for godown is outstanding.

(iii) One month's salary is outstanding.

(iv) Interest on loan from GOU is payable at 12%. This loan was taken on 1-5-2014.

(v) A provision for bad debt is to be maintained at 5% on sundry debtors.

(vi) Insurance premium includes ` 8,000 paid towards proprietor's life insurance policy and the balance of the insurance charges covers the period from 1-4-14 to 30-6-14.

(vii) Depreciate:

(a) Buildings used for business by 5%.

(b) Furniture and fixtures by 10% — one steel table purchased during the year for ` 2,800 was sold for same price but the sale proceeds were wrongly credited to sales account.

(c) Office equipments by 15% — purchase of a typewriter during the year for ` 8,000 has been wrongly debited to purchase account.

(d) Motor car by 20%.

Solution

Trading and Profit and Loss Account of Manikandan for the year ended 31-3-14

Particulars	`	`	Particulars	`	`
To Opening stock		1,24,000	By Sales	4,60,000	
To Purchases	2,80,000		*Less:* Sale of fittings	2,800	
Less: Purchase of office				4,57,200	
equipment	8,000		*Less:* Returns	8,400	44,88,000
	2,72,000		By Closing stock		8,800
Less: Returns	5,200	2,66,800			
To Freight on purchases		2,400			

To Gross Profit c/d		1,43,600			
		5,36,800			**5,36,800**
To Salaries			By Gross profit b/d		1,43,600
Add: Outstanding	22,000		By Discount received		3,200
To Rent for godown	200	24,000			
Add: Outstanding	11,000				
To Interest on loan	1,000	12,000			
Add: Outstanding	5,400				
To Rates and taxes	1,200	6,600			
To Discount allowed		4,200			
To Carriage outward		4,800			
To Printing & stationery		4,000			
To Electric charges		3,600			
To Insurance premium		4,400			
Less: Premium on own	11,000				
Life policy	8,000				
Less: Prepaid					
To General office exp.	3,000	Nil			
Add: New provision	4,000				
Less: Existing provision	2,600				
To Bank charges	3,000	3,200			
To Motor car expenses		7,200			
To Depreciation on :					
Building		3,000			
Furniture and fittings		4,000			
Office equipments		6,000			
Motor car		8,000			
To Net Profit transferred					
Capital A/c		39,200			
		1,46,800			**1,46,800**

Balance Sheet of Manikandan as on 31-3-14

Liabilities	₹	₹	**Assets**	₹	₹
Capital	3,24,000		Buildings	1,20,000	
Add: Net profit	39,200		*Less:* Depreciation	3,000	1,17,000
	3,63,200		Furniture and fittings	42,800	
Less: Drawings		3,31,200	*Less:* Sale	2,800	
(24,000 + 8,000)	32,000			40,000	
Loan from Gopu	60,000		*Less:* Depreciation	4,000	36,000
Add: Outstanding interest	1,200	61,200	Office Equipments	32,000	
Sundry creditors		1,06,000	*Add:* Purchase	8,000	34,000
Outstanding expenses:				40,000	
Salaries	2,000		*Less:* Depreciation	6,000	
Rent for godown	1,000	3,000	Motor car	40,000	
			Less: Depreciation	8,000	32,000
			Stock		88,000

			Sundry debtors	1,72,000	
			Less: Provision for B.D	8600	1,63,400
			Cash at Bank		5,200
			Cash at Hand		22,800
			Prepaid Insurance		3,000
		5,01,400			**5,01,400**

Illustration 10

From the following particulars presented by Mr. S. Tendulkar, prepare a Trading A/c, Profit and Loss A/c for the year ended 31st Dec., 2014 and Balance sheet as on that date.

Debit balances	`	**Credit balances**	`
Plant and machinery	1,00,000	Sales (net)	40,000
Drawings	36,000	Capital	1,00,000
Purchases	1,20,000	Creditors	40,000
Sundry debtors	80,000	Bank overdraft	20,000
Wages	20,000	Provision for debts	4,000
Carriages	6,000	Cash credit	20,000
Salaries	14,000	Bills payable	16,000
Rent	12,000		6,00,000
Repairs	6,000		
Insurance	10,000		
Opening stock	24,000		
Land and buildings	80,000		
Furniture	20,000		
Discount	40,000		
Suspense A/c	32,000		
	6,00,000		**6,00,000**

Adjustments:

(i) Closing stock ` 60,000

(ii) Purchases include purchase of materials used for the construction of buildings ` 10,000.

(iii) Sales include sale of furniture at a selling prices of ` 2,000 (book value ` 4,000)

(iv) Purchased a plant for ` 10,000, wrongly debited to purchase account.

(v) A sale of goods to a customer not debited to customers account ` 32,000.

(vi) Stock destroyed by fire amounted ` 20,000. Insurance Company admitted only ` 16,000 as its liability.

(vii) Wages include ` 6,000 incurred for the erection of a machinery.

(viii) The proprietor Mr. S. Tendulkar took goods for his own from the business amounted to ` 2,000.

(ix) Rent included ` 2,000 paid for Mrs. S. Tendulkar's residential portion.

(x) Purchase of stationery for ` 200 was debited to repairs account

(xi) A customer's cheque returned dishonoured wrongly debited to discount account ` 2,000.

Solution

Trading and Profit and Loss Account of S. Tendulkar for the year ended 31-12-14

Particulars	`	`	Particulars	`	`
To Opening stock		24,000	By Sales	4,00,000	3,98,000
To Purchases	1,20,000		*Less:* Furniture	2,000	60,000
Less: Buildings	10,000		By Closing Stock		2,000
	1,10,000		By Stock destroyed by fire		3,36,000
Less: Drawings	2,000				
	1,08,000				
Less: Plant and Machinery	10,000	98,000			
To Wages	20,000				
Less: Plant and Machinery	6,000	14,000			
To Carriage		6,000			
To Gross Profit c/d		3,36,000			
		4,78,000			**4,78,000**
To Salaries		14,000	By Gross profit b/d		3,36,000
To Rent	12,000		By Provision for bad debts		4,000
Less: Drawings	2,000	10,000			
To Repairs	6,000				
Less: Stationery	200	5,800			
To Insurance		10,000			
To Discount	40,000				
Less: Cheque Dishonoured	2,000	38,000			
To Loss on sale of furniture		2,000			
To Stationery		200			
To Loss of stock by fire		4,000			
To Net Profit transferred to Capital A/c		2,56,000			
		3,40,000			**3,40,000**

Balance Sheet of Mr. S. Tendulkar as on 31-12-14

Liabilities	`	`	Assets	`	`
Capital	1,00,000		Plant and Machinery	1,00,000	
Less: Drawings	2,56,000		*Add:* Wages	6,000	
	3,56,000			1,06,000	1,16,000
Add: Net profit	36,000	3,16,000	*Add:* Additions	10,000	
Purchases (2000)			Land and Buildings	80,000	
Rent (2000)			*Add:* Additions	10,000	90,000

Creditors		40,000	Furniture	20,000	
Bank Overdraft		20,000	*Less:* Sale of furniture	4,000	16,000
Cash Credit		20,000	Stock		
Bills Payable		16,000	Sundry debtors	80,000	
			Add: Cheque		60,0000
			Dishonoured	2,000	1,14,000
			Add: Suspense	82,000	
			Suspense A/c	32,000	
			Less: Debtors	32,000	Nil
			Insurance claim	32,000	16,000
		4,12,000			**4,12,000**

Illustration 11

The following figures have been extracted from the records of Fancy Stores, a proprietor concern as at 31st December, 2014.

Particulars	`	**Particulars**	`
Furniture	15,000	Insurance	60,000
Capital	5,40,000	Rent	2,20,000
Cash in hand	30,000	Sundry debtors	6,00,000
Opening stock	5,00,000	Sales	60,00,000
Fixed deposits	13,46,000	Advertisements	1,00,000
Drawings	50,000	Postage and telephone	34,000
Provision for bad debts	30,000	Bad debts	20,000
Cash at Bank	1,00,000	Printing and stationery	90,000
Purchases	30,00,000	General charges	1,30,000
Salaries	1,90,000	Sundry creditors	4,00,000
Carriage inwards	4,10,000	Deposit from customers	60,000

Prepare Trading and Profit and Loss account an Balance Sheet after taking into consideration the following further information:

(i) The closing stock as on 31-12-2014 was ` 1,00,000.

(ii) A sale of ` 2,50,000 made for cash had been credited to the purchases accounts

(iii) Salary of ` 20,000 paid to an employee had been entered in the cash book bank column as ` 10,000.

(iv) Charge depreciation on furniture at 10%.

(v) Furniture had been sold during the year for ` 1,00,000 and the proceeds had been credited to furniture account. The written down value of furniture sold was ` 50,000.

(vi) Sum of ` 1,00,000 received from a party which had purchased some stock belonging to a separate business of the proprietor was credited to the sundry debtors account.

(vii) The proceeds of a matured fixed deposits amounting to ` 2,54,000 had been credited to the fixed deposit account. The original amount of the deposit was ` 2,00,000.

(viii) There was an outstanding liability for rent of ` 20,000.

(ix) An advance of ` 10,000 paid to an employee against his salary of January 1996 had been debited to the salary accounts

(x) The office premises were sublet from December 2014 for a monthly rental of ` 10,000, but the rent for December has not yet been received.

Solution

Trading and profit and loss accounts of fancy stores for the year ended 31-12-14.

Particulars	`	`	Particulars	`	`
To Opening stock		5,00,000	By Sales		62,50,000
To Purchases		32,50,000	By Closing stock		1,00,000
To Carriage inwards		4,10,000			
To Gross Profit c/d		21,90,000			
		63,50,000			**63,50,000**
To Salaries	1,90,000		By Gross Profit b/d		21,90,000
Less: Advance salary	10,000	1,80,000	By Interest on deposit		54,000
To Insurance		10,000	By Rent from subletting		10,000
To Advertisement		1,00,000	By Profit on sale of furniture		50,000
To Postage and telephone		3,40,00			
To Bad debts		20,000			
To Printing and stationery		90,000			
To General charges		1,30,000			
To Depreciation on furniture		20,000			
To Net Profit transferred to Capital A/c		1,420,000			
		23,04,000			**23,04,000**

Balance Sheet of Fancy Stores as on 31-12-14

Liabilities	`	`	Assets	`	`
Deposits from customers		60,000	Cash in hand		30,000
			Cash in bank		90,000
Sundry creditors		4,00,000	(1,00,000 – 10,000)		1,00,000
		20,000	Stock		
Outstanding rent	5,40,000		Sundry debtors	7,00,000	
Capital	1,00,000		*Less:* Prov. for BD	30,000	67,000
Add: Addition	6,40,000		Advance salary		10,000
Less: Drawings	50,000		Rent outstanding		10,000
	5,90,000		Furniture	2,00,000	
Add: Net profit	14,20,000	20,10,00	*Less:* Depreciation	20,000	1,80,000
			Fixed deposits		14,00,00
		24,90,000			**24,90,000**

Illustration 12

Sasikala is a manufactures. From the following details prepare:

(i) Sasikala's manufacturing account to show the cost of goods manufactured during the year ended 31st December, 2014, and

(ii) Sasikala's Trading and Profit and Loss Account for the same period.

Particulars	`	Particulars	`
Stock as on 1st Jan., 1994		Travelling expenses	5,400
Raw material	7,000	Manufacturing expenses	5,400
Work-in-progress	1,000	Miscellaneous	4,000
Finished goods	25,400	Returns outwards	1,000
Purchase of raw materials	90,000	Discount allowed	600
Carriage of raw materials	2,000	Discount Received	2,400
Sale of finished goods	3,80,000	Import duty on raw materials	6,000
Stock on 31st Dec., 1994		Sale of waste materials	1,600
Raw materials	13,000	Carriage outwards	12,000
Work-in-progress	12,000	Factory insurance, rent and taxes	1,200
Finished goods	28,000	Bad debts	25,600
Factory wages	60,000	Salaries (including Sasikala's	3,000
Factory expenses	4,800	Salary ` 9,600)	
Return inwards	4,600	Salary of works manager	14,400
Depreciation on machinery	10,800	Office rent and insurance	3,000
Repairs to machinery	9,200	Motive power	7,000
Interest on bank overdraft	600		
Miscellaneous expenses	2,600		
Depreciation on office furniture	2,200		
Selling expenses	10,400		

Sasikala's salary is to be allocated 2/3rd to factory and 1/3rd to office.

Solution

Manufacturing Account of Sasikala for the year ended 31-12-14

Particulars	`	Particulars	`
To Work-in-progress on 1-1-94	10,000	By Sale of waste material	6,000
To Material consumed during the opening stock + net purchases - closing stock [7,000 + 86,000 (*i.e.*, 9,000 – 4,000) – 13,000]	80,000	By Work-in-progress year on 31-12-94	12,000
		By Cost of finished goods transferred to Trading Account	2,28,000
To Carriage on raw materials	2,000		
To Import duty on raw materials	24,000		
To Factory wages	60,000		
To Salary of works manager	14,400		
To 2/3 of Sasikala's salary	6,400		
To Motive power	7,000		

To Factory expenses	4,800		
To Factory insurance, rent and taxes	12,000		
To Manufacturing expenses	5,400		
To Depreciation of machinery	10,800		
To Repairs of machinery	9,200		
	2,46,000		**2,46,000**

Trading and Profit and Loss Account of Sasikala for the year ended 31-12-14

Particulars	`	Particulars	`
To Stock of finished goods (1-1-94)	25,400	By Sales 3,80,000 *Less:* Returns inwards 4,600	3,75,400
To Manufacturing account (cost of finished goods)	2,28,000	By Stock of finished goods on 31-12-04	28,000
To Gross profit c/d	1,50,000		
	4,03,000		**4,03,400**
To Depreciation on office furniture	2,200	By Gross Profit b/d	1,50,000
		By Discount received	600
To Interest on bank overdraft	600		
To Miscellaneous expenses	2,600		
To Travelling expenses	5,400		
To Selling expenses	10,400		
To Discount allowed	1,000		
To Carriage outwards	1,600		
To Bad debts	1,200		
To Salaries	19,200		
Less: 2/3 of Sasikala's salary 6,400			
To Office rent and insurance 5,600	3,000		
To Net Profit transferred to Capital Account	1,03,400		
	1,50,600		**1,50,600**

EXERCISE

(A) Short Answers

1. Pass necessary adjustments in Mr. X's journal on 31st December, 2014;
   (a) ` 20,000 for wages was outstanding.
   (b) Write off depreciation on machinery ` 50,000
   (c) ` 15,000 was received in advance as interest.
2. Pass adjustment entries for the following:
   (a) Closing stock ` 49,280
   (b) Provide depreciation on vehicles @ 10% on cost of ` 1,40,000.

(c) Materials purchased and received from Mr.X for which no entry is passed in register ` 10,000

3. Pass necessary journal entries for the following while finalizing the annual accounts:

   (a) Debtors include ` 500 receivable from the proprietor for goods drawn by him.

   (b) Trade debtors of ` 1,05,000 include ` 5,000 which are considered bad. Provide for doubtful debts @ 2.5%.

   (c) Provide for discount on creditors on closing day @ 2.5% on ` 85,000

4. The trial balance of a trader shows ` 3,000 to the debit of general expenses A/c included in that are:

   (a) Travelling expenses ` 1,000

   (b) School fees of his children ` 30

   (c) Subscription and other fees ` 500 paid to the Ladies club on behalf of the trader's wife.

   Make the necessary adjusting journal entry.

   [**Ans:** Debit ` 1,000 to Travelling Exp A/c and ` 800; To Drawings A/c, crediting General Exp A/c ` 1,800]

5. Dawson, a businessman, has invested on 1-4-2014 ` 10,000 in Government securities on which he gets a net interest of 6%p.a. after 31st March every year. His accounts are closed on 31st December every year. Find out the interest earned by him but not yet received and show by means of journal entry the necessary adjustment.

   [**Ans:** Accrued interest ` 450]

6. Pass journal entries for the following transactions:

   (a) Samples worth ` 5,000 distributed during a sale campaign programme.

   (b) Proprietor brought his personal car into the business and the value of the same is ` 1,00,000.

   (c) Interest of ` 9,000 received on investment amounting to ` 50,000 (20% Govt. of India Bonds).

   The above interest was net of income tax.

7. Show the necessary adjustments in Trading account and Balance Sheet from the following information.

   31.12.2014 value of goods still with customers sold on sale or return basis, treated as sales ` 40,000

   G.P on Cost – 25%

   [**Ans:** Cost of stock with customer: ` 32,000]

8. Which of the following items of expenditure and income belong to the current accounting year?

   (a) Cash sales;
   (b) Outstanding expense;
   (c) Credit purchases;
   (d) Salaries paid to employees;
   (e) Rent received in advance;
   (f) Commission received but not yet earned

   [**Ans:** (a); (b); (c); (d)]

9. Mr. Gotham has ` 50,000 to the credit of his capital account on 1-1-2014. His drawings during the same year amounted to ` 7,000.

   You are to charge interest on capital at 5% p.a. and ` 430 on drawings. Ascertain his closing capital, assuming that his net profit for the year after all adjustments is ` 12,400.

   [**Ans:** ` 57,470]

10. From the following, calculate the amount of provision for doubtful debts to be debited to profit and loss account:

    Opening provision for doubtful debts ` 2,400

    Closing sundry debtors ` 42,000

    Bad debts yet to be written off ` 2,000

    Provide for doubtful debts at 10% on debtors.

    [**Ans:** Amount to be debited to profit and loss account ` 3,600]

11. On 1st Jan., 2014, the provision for doubtful debts account in the books of a firm which maintain it at 5% had a credit balance of ` 3,300. During the year the bad debts amounted to ` 2,400 and the debtors at the end of the year were ` 60,000. Show provision for doubtful debts account and bad debts account for the year 2014.

    [**Ans:** Debit to profit and loss account – ` 2,100]

12. Make adjustments from the information given below while preparing profit and loss account.

	Dr.	Cr.
Loan @ 15% p.a.		20,000
Interest on loan	2,000	
Deposit @ 14% p.a.	15,000	
Interest on deposit		1,000

    [**Ans:** Add ` 1,000 interest outstanding to ` 2,000 on the debit side of profit and loss account add ` 1,100 to interest on deposit of ` 1,000 and show the total on the credit side of profit and loss account]

13. During the year ended 31-12-2014, a firm suffered the following losses. Explain how you would treat them in the accounts on 31-12-2014:

    (a) Stock lost ` 15,000

    (b) A machinery of the value of ` 21,000 was discarded, being totally out of order.

    (c) A portion of the buildings worth ` 12,000 became completely useless.

    [**Ans:** (a) Credit trading account ` 15,000 and debit profit and loss account ` 15,000 assuming no insurance; (b) Debit profit and loss account and credit machinery account ` 21,000; (c) Debit profit and loss account and credit building account with ` 12,000]

14. A manager gets 5% commission on net profit after charging such commission. What shall be his commission if gross profit is ` 0.96,000 and expenses of indirect natures other than manager's commission are ` 12,000?

    [**Ans:** Manager's Commission ` 4,000 i.e., 84,000 × 5/105]

15. Calculate gross profit and cost of goods sold from the following information:

    Net sales ` 2,00,000

    Gross Profit is 25% on cost.

    [**Ans:** G.P. ` 40,000; C.O.G.S. ` 1,60,000]

16. Ascertain soc tog goods sold from the following:

	`		`
Opening stock	17,000	Indirect expenses	10,400
Purchases	61,400	Closing stock	18,000
Direct expenses	9,600		

[**Ans:** C.O.G.S. ` 70,000]

17. Calculate Net Profit from the following:

	`
Purchase (200 units)	10,000
Freight and carriage	1,200
Rent and advertising	600
Sales (150 units)	10,800

[**Ans:** N.P. ` 180; closing stock ` 2,800]

Hint: Closing stock ` 11,200 × 50/200

18. The drawings of appropriate for the year 2014 are ` 30,000. profit for the year ` 50,000 and capital at the end ` 1,40,0,00. calculate the capital at the beginning.

[**Ans:** Opening capital: ` 1,20,000]

19. Prepare trading account of a trader for the year ending 31st December, 2014 from the following data:

	`
Opening stock (1.1.14)	50,000
Goods purchased during 2014	2,80,000
Freight and packing on the above	20,000
Closing stock (31.12.14)	60,000
Sales	3,80,000
Packing expenses on sales for distribution	12,000

[**Ans:** Gross profit – ` 90,000]

Hint: Ignore packing expenses

20. From the information given below, prepare Trading Account.

	`
Opening stock	1,00,000
Purchases	1,50,000
Purchases returns	25,000
Direct expenses	10,000
Carriages inwards	5,000
Sales	4,00,000
Closing stock	50,000

[**Ans:** Gross profit: ` 2,10,000]

Provision on Debtors and Creditors

1. From the following figures, you are required to prepare:
   (a) Provision for doubtful debts account
   (b) Bad debts account
   (c) Profit and loss account

Jan. 1, 2000	Provision for bad debts	` 2,500
Dec. 31, 2000	Bad debts	` 2,870
Dec., 1, 2000	Debtors	` 20,000

   Information: Make provision for bad debts at 5% on debtors.

   [**Ans:** Debit to profit and loss: ` 370]

2. The provision for bad and doubtful debts stood at ` 3,200 on 31st December, 2013. On 31st December, 2014, debtors stood at ` 1,42,250 out of which ` 2,250 had to be written, off. On December 2015, the debtors were ` 76,900 out of which ` 1,900 had to be written off as bad debts. The firm creates a bad debts provision to the extent of 5% on the debtors. Make the necessary journal entries and show the provision for bad and doubtful debts account for 2014 and 2015.

   [**Ans:** In 2014, debit profit and loss ` 6,050; In 2014, credit profit and loss ` 1,350]

3. On 1st Jan., 2012, M/s. Kamakshi had a bad debt provision of ` 2,600. On 31st December, 2012, the total debtors amounted to ` 73,600 out of which ` 1,600 were bad and had to be written off. The firm wants to maintain a provision for bad debts @5% of the debtors.

   On 31st December, 2013, the total debtors amounted to ` 1,280 out of which ` 1,280 had to be written off as bad debts. The provision for bad debts is to be maintained at 5% of debtors.

   Show the bad debts account and the provision for bad debts account for 2012 and 2013.

   [**Ans:** In 2012, debit profit and loss account ` 2,600 and in 2013, credit profit and loss account ` 320]

4. Following details are provided to you:

	2008	2009	2010
Debtors at the end	50,000	30,000	70,000
Bad debts written off	4,000	1,000	5,000
Provision for doubtful debts (opening) 3,000	–	–	
Provision to be maintained for doubtful debts	10%	5%	6%

   Prepare provision for doubtful debts account for three years.

   [**Ans:** 2012: Balance of PBDD account debited to profit and loss account ` 6,000. 2008: Balance of PBDD account credited to profit and loss account ` 2,500. 2013: Balance of PBDD account debited to profit and loss account ` 7,700)

5. The trial balance of Thiru Manain as on 1-12-2012 shows the following (among others).

	`
Debtors	80,000
Bad debts	1,000
Provision for bad debts (1-1-12)	2,000

You are required to provide for bad and doubtful debts at 5% on debtors. Give the necessary Journal entries and shoe the bad debts account provision for Bad Debts A/c, Profit and Loss account and the Balance Sheet.

[**Ans:** Debit profit and loss account – ` 3,000]

Preparation of Final Accounts

1. From the following trial balance of Ravi, prepare trading and profit and loss account for the year ended 31st December, 2014 and a balance sheet as on that date.

Trial Balance

Particulars	`	`
Capital		40,000
Sales		25,000
Purchases	15,000	
Salaries	2,000	
Rent	1,500	
Insurance	300	
Drawings	5,000	
Machinery	28,000	
Bank balance	4,500	
Cash	2,000	
Stock 1.1.14	5,200	
Debtors	2,500	
Creditors		1,000
	66,000	**66,000**

Adjustment Required

Stock on 31.12.14 ` 4,900

Salaries unpaid ` 300

Rent paid in advance ` 200

Insurance prepaid ` 90

[**Ans:** G.P. ` 9,700, N.P. ` 5,890; B/S Total ` 42,190]

2. From the following trial balance, prepare trading, profit and loss account for the year ended 31.12.2014 and a balance she as on that date:

Trial Balance

Purchases	11,870	Capital	8,000
Debtors	7,580	Bad debts recovered	25
Return inwards	450	Creditors	1,250
Bank deposit	2,750	Return outwards	350
Rent	360	Bank overdraft	1,570
Salaries	850	Sales	14,690
Travelling expenses	300	Bills payable	1,350
Cash	210		

Stock	2,450		
Discount allowed	40		
Drawings	600		
	27,650		**27,650**

Adjustments:

(i) The closing stock on 31.12.14 was ` 4,200.

(ii) Write off ` 80 as bad debts and create a reserve for bad debts at 5% on sundry debtors.

(iii) Three months rent is outstanding.

[**Ans:** Gross Profit ` 4,470 Net Profit ` 2,595; Balance Sheet total ` 14,285]

3. From the following balances as at 31st December, 2014 of a trader, prepare a trading and profit and loss account for the year 2004 and a balance sheet as on that date:

Particulars	`	**Particulars**	`
Salaries	5,500	Creditors	9,500
Rent	1,300	Sales	32,000
Cash	1,000	Capital	30,000
Debtors	40,000	loans	10,000
Trade expenses	600		
Purchases	25,000		
Advances	2,500		
Bank balance	5,600		
	81,500		**81,500**

Adjustments:

(i) The closing stock amounted to ` 9,000.

(ii) One month's salary is outstanding.

(iii) One month's rent has been paid in advance.

(iv) Provide 5% for doubtful debts.

[**Ans:** Gross Profit — ` 16,000; Net Profit – ` 6,200; Balance Sheet total – ` 56,200]

4. Prepare a trading and profit and loss account for the year ended 31st December, 2014 and a balance sheet as on that date from the following trial balance of Mr. Akilan:

Particulars	`	**Particulars**	`
Drawings	45,000	Capital	1,60,000
Goodwill	90,000	Bills payable	35,000
Buildings	60,000	Creditors	70,000
Machinery	40,000	Purchase returns	2,650
Bills receivable	6,000	Sales	2,18,000
Opening stock	40,000		
Purchase	51,000		
Wages	26,000		
Carriage outwards	500		
Carriage inwards	1,000		
Salaries	35,000		

Rent	3,000		
Discount	1,100		
Repairs	2,300		
Bank	25,000		
Cash	1,600		
Debtors	45,000		
Bad debts	1,200		
Sales returns	2,000		
Furniture	6,000		
Advertisements	3,500		
General expenses	450		
	4,85,650		**4,85,650**

Adjustments:

(i) Closing stock was ` 35,000.

(ii) Depreciate machinery and furniture by 10%.

(iii) Outstanding wages ` 1,500.

(iv) Prepaid advertisement ` 500.

(v) Create 5% on debtors for bad debts as provision.

5. From the following trial balance of Thirurehman as on 31st March, 2014, prepare trading and profit and loss account and balance sheet taking into account the adjustments:

Debit balance	`	Credit balance	`
Land and buildings	42,000	Capital	62,000
Machines	20,000	Sales	98,780
Patents	7,500	Return outwards	500
Stock 1-4-1994	5,760	Sundry creditors	6,300
Sundry debtors	14,500	Bills payable	9,000
Purchases	40,675		
Cash in hand	540		
Cash at bank	2,630		
Return inwards	680		
Wages	8,480		
Fuel and power	4,730		
Carriage on sales	3,200		
Carriage on purchases	2,040		
Salaries	15,000		
General expense	3,000		
Insurance	600		
Drawings	5,245		
	1,76,580		**1,76,580**

Adjustments:

(a) Stock on 31-3-2014 was ` 6,800.

(b) Salary outstanding ` 1,500.

(c) Insurance prepaid ` 150.

(d) Depreciate machinery @ 10% and patents @ 20%.

(e) Create a provision of 2% on debtors for bad debts.

[**Ans:** Gross profit – ` 43,715; Net profit – ` 16,775; Balance Sheet total – ` 90,330]

6. The following are the balances extracted from the books of Ganesh as on 31-12-2014. Prepare trading and profit and loss account for the year ending 31-12-2014 and a balance sheet as on that date.

Debit Balance	`	**Credit Balance**	`
Drawings	4,000	Capital	20,000
Cash at bank	1,700	Sales	16,000
Cash in hand	6,500	Sundry creditors	4,500
Wages	1,000		
Purchases	2,000		
Stock 1-1-14	6,000		
Buildings	10,000		
Sundry debtors	4,400		
Bills receivable	2,900		
Rent	450		
Commission	250		
General expense	800		
Furniture	500		
	40,500		**40,500**

Adjustments:

(a) Stock on 31-12-14 was ` 4,000.

(b) Interest on capital at 6% to be provided.

(c) Interest on drawings at 5% to be provided.

(d) Wages yet to be paid ` 100.

(e) Rent prepaid ` 50.

[**Ans:** Gross Profit – ` 10,900; Net Profit – ` 8,450; Balance Sheet total: ` 30,050]

7. Below is given the trial Balance of Tripathi Brothers of Ahmedabad as on 31st December, 2014:

Debit Balance	`	**Credit Balance**	`
Opening stock	3,100	Capital	2,000
Buildings	17,000	Bank loan	3,000
Furniture	1,000	Sundry creditors	4,920
Purchases	21,200	Return outwards	420
Salaries	2,200	Interest	130
Bad debts	120	Dividends	110
Cash in hand	1,300	Sales	41,460
Returns inwards	1,020		
Rent	600		

Miscellaneous expenses	500		
Postage	280		
Stationery	260		
Wages	5,200		
Fright and carriage on purchase	560		
Carriage on Sales	800		
Repairs	900		
Sundry debtors	6,000		
	62,040		**62,040**

In additional, the following information is given:

(a) A provision @ 5% for doubtful debts has to be made.

(b) The valve of stock on 31st December, 2014 was estimated at ` 2,980.

(c) In the miscellaneous expenses included is an yearly insurance premium of ` 120. The yearly premium falls due every year on 31st March.

(d) Depreciation on building is to be charged at 10%.

(e) Salaries for December 2014 amounting to ` 200 were not paid till the date of preparing Trial Balance.

Prepare Trading Account and Profit and Loss Account of Tripathi Brothers for the year 2014 and Balance Sheet as on that date.

[**Ans:** Gross Profit:- ` 13,780; Net Profit – ` 6,190; Balance Sheet total – ` 26,310]

8. Prepare Trading and Profit and Loss Account and Balance Sheet as on 31st March, 2014.

Debit Balance	`	**Credit Balance**	`
S. Chandra's Capital account	1,19,400	Manufacturing wages	40,970
S. Chandra's Drawings account	10,550	Sales	3,56,430
Sundry Creditors	59,630	Return inwards	2,780
6% Loan account (Credit)	20,000	Salaries	11,000
Cash in hand	3,030	Rent and taxes	5,620
Cash at Bank	18,970	Interest and Discount (Dr.)	5,870
Sundry debtors (including Kalpana	6,200	Travelling Expenses	1,880
for dishonoured bill of ` 1,000)		Repairs and Renewals	3,370
Bills Receivable	9,500	Insurance (including premium	400
Provision for doubtful debts	2,500	of ` 300 p.a.	
Fixtures and fittings	8,970	Paid up to 30th Sept., 2004)	3,620
Stock 1st April, 2003	89,680	Bad debts	5,620
Purchases	2,56,590	Commission Received	5,640
		Plant and machinery	28,800

Adjustments:

(i) Stock on hand on 31st March, 2014 was ` 1,28,960.

(ii) Write-off half of Kalpana's dishonoured bill.

(iii) Create a provision of 5% on sundry debtors.

(iv) Charge 5% interest on capital.

(v) Manufacturing wages include ` 1,200 for erection of new machinery purchased last year.

(vi) Depreciate plant and machinery by 5% and fixtures and fittings by 10% p.a.

(vii) Commission earned but not received amount to ` 600.

(viii) Interest on loan for the last two months is not paid.

[**Ans:** Gross Profit ` 96,570; Net Profit ` 61,583, Balance Sheet total ` 2,56,233]

9. The following are the balances extracted from the ledger of Karikalan as on December 31, 2014:

Particulars	`	**Particulars**	`
Karikalan's Capital account	20,000	Reserve for discount on debtors	200
Drawings	3,500	Loans @ 9%	5,000
Buildings	10,000	Salaries	4,400
Machinery	2,500	Wages	7,500
Furniture and fittings	600	Rent	2,750
Opening stock	12,500	Travelling expenses	1,250
Cycle	400	Postage and telegrams	135
Purchases	75,000	Rates and taxes	90
Sales	1,25,000	Carriage inwards	2,500
Sales Returns	5,000	Carriage outwards	750
Duty paid on purchases	15,000	Interest paid	375
Sundry debtors	10,000	General charges	900
Sundry Creditors	7,500	Bad debts	300
Reserve for bad and doubtful debts	400	Cash in hand	250
		Cash at Bank	2,400

The following adjustments are necessary:

(a) Stock on 31-12-14 ` 14,00.

(b) Provide the following outstanding: Salary ` 400; Rent ` 250; Wages ` 600 and Interest ` 75.

(c) Maintain the reserve for doubtful debts at 5% and the reserve for discount on debtors at 2.5% on sundry debtors.

(d) Provide depreciation for building 2.5%, furniture 6% and cycle 15%.

Prepare Trading and Profit and Loss account and the Balance Sheet for the year ended 31-12-03.

[**Ans:** Gross Profit ` 20,900; Net Profit ` 8,491.50, Balance Sheet Total ` 38,816.50].

10. Edward's books show the following balances. Prepare his Trading and Profit and Loss account for the year ended 31st December, 2014 and a balance Sheet as at that date:

Debit Balance	`	**Credit Balance**	`
Drawings	5,000	Capital	1,08,850
Bills Receivable	4,500	Loan at 6% p.a.	20,000
Land and Buildings	37,770	Sales	3,50,000
Sundry Debtors	62,000	Interest on investments	5,640

Wages and Salaries	40,970	Sundry Creditors	59,000
Return Inwards	2,780	Commission received	630
Purchases	2,56,590	Return outwards	6,430
Postage and telegrams	5,620		
Stock on 1-1-92	89,680		
Printing and Stationery	880		
Travelling expenses	12,000		
Interest on loan paid	300		
Petty Cash	70		
Bank Balance	8,800		
Repairs	3,620		
Commission	470		
Furniture	500		
Investments	19,000		
	5,50,550		**5,50,550**

Adjustments:

(i) Closing Stock was ` 1,28,960 on 31-12-2014.

(ii) Commission received but not earned ` 130.

(iii) Travelling expenses were overdrawn by the employees to the extent of ` 2,000.

(iv) Create a 5% Reserve on sundry debtors and allow 2% discount on debtors and creditors.

(v) Interest on loan due for 9 months.

(vi) 1/4th of wages and salaries should be charged to Trading Account.

[**Ans:** Gross Profit ` 1,26,097.50; Net Profit – ` 76,622, Balance Sheet total ` 2,59,322]

11. From the following Trial Balance of Mr. Xavier as on 31-3-2014, Prepare Trading account Profit and Loss account for the year ended 31-3-2014 and a Balance Sheet as on that date after making necessary adjustments:

Trial Balance

Debit Balance	`	**Credit Balance**	`
Xavier's Drawings	12,000	Xaviers's Capital	60,000
Furniture and fixtures	4,000	Returns Outward	2,000
Plant and Machinery	30,000	Sales	1,30,000
Opening Stock	20,000	Creditors	12,000
Purchases	80,000	Loan at 6% p.a. taken from	10,000
Salaries and Wages	22,400	P.Abdul on 1-1-14	600
Debtors	20,400	Discount	2,14,600
Returns inward	5,000		
Postage and telegrams	1,500		
Rent, rates & taxes	3,600		
Bad debts written off	400		
Trade Expenses	200		
Interest on loan from P. Abdul	150		

Insurance	800		
Travelling expenses	500		
Sundry expenses	300		
Cash in hand	3050		
Cash at bank	10,300		
	2,14,600		**2,14,600**

Adjustments:

(i) Closing Stock: Cost price ` 21,000.

(ii) Market Price: Market price ` 25,000.

(iii) Of the debtors, ` 400 are bad and should be written off. Create a reserve for discount on debtors 2.5%.

(iv) Interest on capital is to be calculated at 6% p.a. and on drawings ` 330.

(v) Prepaid insurance amounted to ` 100.

(vi) Depreciate furniture and fixtures by 5%, plant and machinery by 10%.

(vii) Make a reserve for discount on creditors @ 2%.

[**Ans:** Gross Profit ` 48,000; Net Profit ` 10,920, Balance Sheet total ` 84,750)

12. From the following Trial Balance of Appu as on 31st March, 2014, Prepare a Trading and Profit and Loss account for the year and a Balance Sheet as on that date:

Debit Balance	`	**Credit Balance**	`
Stock on 1-4-2014:		Sundry Creditors	23,500
Raw materials	21,000	Bills payable	7,500
Work-in-progress	9,500	Sale of scrap	2,500
Finished goods	15,500	Commission	450
Sundry Debtors	24,000	Provision for doubtful debts	1,650
Carriage	1,500	Capital	1,00.000
Bills Receivable	15,000	Sales	1,67,200
Wages	13,000		
Salaries	10,000		
Postage and telegrams	1,000		
Repairs and Renewals	1,100		
Purchases	85,000		
Cash at Bank	17,000		
Plant and Machinery	70,000		
Furniture	10,000		
Rent	6,000		
Lighting	1,350		
General expenses	1,850		

Adjustments

(i) Stock on 31st March, 2014:

Raw materials – ` 16,200

Work-in-progress – ` 7,800

Finished goods – ` 18,100

(ii) Salaries and wages outstanding were ` 900 and ` 2,000.

(iii) Machinery is to be depreciated by 10% and furniture by 7.5%.

(iv) Office premises occupy quarter of total area. Lighting is to be charged as to two-third to factory and one-third to office.

[**Ans:** Gross Profit ` 56,400: Net Profit ` 36,450; Balance Sheet total ` 1,70,350]

13. Prepare Trading and Profit and Loss Account and Balance Sheet for the year ended 31-3-14.

Particulars	`
Capital	80,000
Drawings	6,000
Opening Stock (1-4-14)	45,000
Purchases	2,50,000
Sales	3,10,000
Furniture	10,000
Debtors	40,000
Freight and Octroi	4,800
Trade Expenses	500
Salary	5,500
Rent	2,400
Advertisement	5,000
Insurance Premium	400
Commission earned	1,300
Discount allowed	200
Bad debts	1,800
Provision	900
For Bad Debts	20,000
Cash	5,200
Bank	5,800
Goodwill (at cost)	20,000

Adjustments:

(a) Closing stock ` 53,000.

(b) Salaries have been paid for 11 months only.

(c) Prepaid Insurance Premium ` 100.

(d) Commission earned but not received ` 122.

(e) Create 3% provision

(f) For bad debts in debtors.

(g) Depreciation on furniture at 10% is to be charged.

(h) One-fourth of advertisements is to be written off.

[**Ans:** G.P. ` 63,200; N.P. 50,872: B/S total: ` 1,45,372]

Hint: Difference in Trial balance ` 9,600 (Dr).

14. The following in trial balance from the books of Mr. Rahul on 31st December, 2014.

Particulars	Dr. `	Cr. `
Furniture and Fittings	640	—
Motor Vehicles	6,250	—
Buildings	7,500	—
Capital account	—	12,500
Bad debts	125	—
Provision for bad debts	—	200
Sundry debtors and creditors	3,800	2,500
Stock on 1st January, 2014	3,460	—
Purchases and sales	5,475	15,450
Bank Overdraft	—	2,850
Sales and Purchases returns	200	125
Advertising	450	—
Interest Account	118	—
Commission	—	375
Cash	650	—
Taxes and insurance	1,250	—
General Expenses	782	—
Salaries	3,300	—
	34,000	**34,000**

Adjustments:

(i) Stock in hand on 31-12-2014 was ` 3,250.

(ii) Depreciate building @ 5%, Furniture and fittings @ 10% and Motor vehicles @ 20%.

(iii) ` 85 is due for interest on Bank overdraft.

(iv) Salaries ` 300 and taxes ` 120 are outstanding.

(v) Insurance amounting to ` 100 is prepaid.

(vi) One-third of the commission received is in respect of work to be done next year.

(vii) Write off further ` 100 as bad debts and provision for bad debts is to be made equal to 5% on sundry debtors.

Prepare Trading and Profit and Loss Account for the year ending 31-12-2014 and a Balance Sheet as on that date.

[**Ans:** Gross Profit ` 9,690; Net Profit ` 1,736; Balance Sheet total ` 20,216]

15. The following is the Trial Balance of Anbumani as on 31-12-2014.

Debit Balance	`	Credit Balance	`
Cash in hand	540	Sales	98,780
Cash at bank	2,630	Returns outwards	500
Purchases	40,675	Anbumani's capital	71,000
Returns inwards	680	Creditors	6,300
Wages	10,480		
Fuel and power	4,730		

Carriage inwards	2,040		
Carriage outwards	3,200		
Opening stock	5,760		
Premises	30,000		
Lands	10,000		
Machinery	20,000		
Patents	7,500		
Salaries	15,000		
Sundry Expenses	3,000		
Insurance	600		
Drawings	5,245		
Debtors	14,500		
	1,76,580		**1,76,580**

Taking into consideration the following adjustments, prepare Trading and Profit and Loss account and a Balance Sheet as on 31-12-2014.

(a) Closing stock ` 6,800 in 31-12-2014.

(b) ` 2,000 spent on erection of a shed were included in wages account.

(c) The insurance policy expires on 30-6-2015.

(d) Provide 5% for doubtful debts.

(e) ` 2,000 is to be transferred to Reserve Fund out of profits if any.

[**Ans:** G.P. ` 43,715; N.P. ` 21,490; Balance profit transferred to B/S ` 19,490; B/S total: ` 93,545]

16. From the following particulars, prepare a trading and profit and loss account for the year ended 31-12-2014 and the Balance Sheet as on that date:

Trial Balance

Particulars	**Dr. `**	**Cr. `**
Cash at Bank	20,500	
Capital account		80,000
Drawings account	6,000	
Machinery	25,000	
Stock on 1-1-2014	15,000	
Purchases	82,000	
Sales returns	2,000	
Sundry Debtors	20,600	
Furniture	5,000	
Taxes	2,000	
Carriage Outwards	500	
Rent	4,600	
Printing and Stationery	800	
Trade expenses	400	
Sundry Creditors		10,000
Sales		1,20,000

Purchase returns		1,000
Postage and Telegram	800	
Reserve for bad and doubtful debts		400
Discount		800
Rent received		1,200
Insurance premium	700	
Salary and wages	21,300	
Cash in hand	6,200	
	2,13,400	**2,13,400**

Adjustments:

(i) Stock on 31-12-2014 ` 14,600.

(ii) Write-off bad debts ` 600.

(iii) Reserve for bad doubtful debts at 5% on sundry debtors is required

(iv) Provide reserve for discount on debtors at 2% and reserve for discount on creditors also at 2%

(v) Depreciate machinery and furniture at 5% and 20% respectively.

(vi) Prepaid Insurance ` 100.

(vii) A fire occurred on 25-12-2014 destroying stock to the extent of ` 5,000. The stock were insured and the insurance company reimbursed the loss.

[**Ans:** Gross Profit – ` 41,600; Net Profit – ` 8,970; Balance Sheet total – ` 92,770]

17. From the following Trial Balance of Mr. Satish, prepare Trading and Profit and Loss account for the year ended 30th June, 2014 and a Balance Sheet as on that date.

Particulars	**Dr. `**	**Cr.`**
Satish's Capital		71,000
Cash in hand and at Bank	3,900	98,800
Purchases and sales	41,000	500
Returns	600	
Productive wages	10,500	
Power and fuel	4,000	
Carriage outward	15,000	
Carriage inward	3,200	
Stock (1-7-13)	2,000	
Building	5,800	
Plant and machinery	40,000	
Furniture	20,000	
Debtors and creditors	7,500	
General expenses	14,500	6,300
Insurance	3,000	
Drawings	600	
Salary	5,000	
	1,76,600	**1,76,600**

Adjustments:

(i) Charge 5% interest on drawings.

(ii) Goods purchased worth ` 5,000 were received and included in closing stock.

(iii) But were not entered in purchases book.

(iv) Prepaid insurance amounted to ` 170.

(v) Salaries and advertisement bill are outstanding to the extent of ` 500 and ` 1,000 respectively.

(vi) Building, machinery and furniture are to be depreciated by ` 2,000, ` 3,000 and ` 1,500 respectively.

(vii) Stock on 30th June, 2014 was valued at ` 7,000

[**Ans:** Gross Profit ` 37,400; Net Profit ` 8,020; Balance Sheet total ` 86,570]

18. The following Trial Balance has been extracted from the books of Rajesh on 31-12-2014.

Debit Balance	`	**Credit Balance**	`
Drawings A/c	2,000	Capitals account	1,76,000
Plant and machinery	1,00,000	Sales	4,68,000
Furniture and fixtures	12,000	Returns outward	4,000
Loose tools	20,000	Discounts	6,000
Goodwill	10,000	Sundry creditors	24,000
Opening Stock (1-1-14)	20,000	Reserve for doubtful debts	2,000
Purchases	2,12,000	Bank overdraft	20,000
Returns Inward	8,000		
Wages	1,00,000		
Carriage Inwards	12,000		
Salaries	41,600		
General Expenses and Insurance	72,000		
Rent and taxes	14,400		
Postage and telegrams	4,000		
Sundry debtors	56,000		
B. Balu	2,000		
Cash and Bank Balances	14,000		
	7,00,000		**7,00,000**

Adjustments:

(i) Stock on 31st December, 2014 was ` 30,800.

(ii) Unexpired insurance was ` 400.

(iii) Provision for doubtful debts is to be maintained at 5% on sundry debtors.

(iv) Depreciate plant and machinery at 5% and furniture and fixtures at 6%. Loose tools are revalued at ` 16,000.

(v) Remuneration of ` 2,000 paid to Shri. B. Balu, a temporary employee, Stands debited to his personal account and it is to be corrected.

You are required to prepare. Trading and Profit and Loss account for the year ended 31-12-2014 and a Balance Sheet as on that date. ***[Delhi Hr. Sec. Exam]***

[**Ans:** Gross Profit – ` 1,50,800; Net Profit – ` 12,680; Balance Sheet total – ` 2,30,680]

19. On 31st December, 2014, the following Trial Balance was extracted from the books of Sridharan.

Debit Balance	`	Credit Balance	`
Drawings	3,000	Capital	28,000
Sundry Debtors	20,100	Sundry Creditors	10,401
Interest on loan	300	Loan on Mortgages	9,500
Cash in hand	2,050	Bad debts Reserve	710
Stock on 1-1-2014	6,839	Sales	1,10,243
Motor Vehicles	10,000	Purchase Returns	1,346
Cash at Bank	3,555	Discounts	540
Land and Buildings	12,000	Bills payable	2,614
Bad debts	525	Rent received	250
Purchases	66,458		
Sales Returns	7,821		
Carriage inward	2,404		
Carriage inward	2,929		
Salaries	9,097		
Rents, taxes and insurance	2,891		
Advertising	3,264		
General expenses	3,489		
Bills Receivable	6,882		

You are required to prepare Trading and Profits and Loss account for the year ended 31-12-2014 and Balance Sheet as on that date, after making the following adjustments:

(i) Stock in stock on 31st December, 2014 was valued at ` 6,250.

(ii) Depreciate Land and Buildings at 2.5% and Motor vehicles at 20%.

(iii) Interest on Loan at 6% per annum is unpaid for six months.

(iv) Salaries amounting to ` 750 and rates amounting to ` 350 are outstanding.

(v) Prepaid insurance amounted to ` 150.

(vi) The provision for bad debts is to be maintained at 5% on sundry debtors.

(vii) Goods costing ` 500 were send to a customer on sale or return for ` 600 on 30th December, 1990 and had been recorded in the books as actual sales.

(viii) Provide for Manager's Commission at 10% on net profits after charging such commission.

[**Ans:** Gross Profit ` 33,692; Net Profit - ` 7,920; Manager's Commission ` 792; Balance Sheet total ` 57,612].

Hint: Provide interest on loan for 6 months @ 6% p.a.

20. On 31st December 2014, the Trial Balance of Janakiraman & Co., was as follows:

Debit Balance	`	Credit Balance	`
Opening Stock		Capital (fixed)	1,00,000
Debtors	40,000	Creditors	15,000
Bills Receivable	30,000	Bills payable	7,500
Carriage inward	1,500	Miscellaneous	450

Wages	13,000	Receipts	450
Salaries	10,000	Commission	2,500
Telephone	1,000	Bad debts provision	550
Repairs	350	Sales	1,67,200
Purchases	85,000		
Cash at Bank	17,000		
plant and machinery	65,800		
Furniture	9,000		
Miscellaneous Expenses	350		
Depreciation	5,200		

The following additional information is to be taken into consideration:

(i) Closing stock amounted to ` 50,000.

(ii) Bad debts provision to be equal to 14/4% of debtors.

(iii) Interest on capital to be provided for at 2.5% p.a.

(iv) Provide outstanding liabilities: Salaries – ` 2,500; Wages – ` 1,750; Rent – ` 7,500.

(v) It was discovered that stock sheets as on 31-12-2002 were over cast to the extent of ` 1,000.

Prepare Trading and Profit and Loss account of the firm for the year ended 31st December, 2014 and a balance sheet as at that date:

[**Ans:** Gross Profit ` 76,950; Net Profit ` 49,675; Balance Sheet total ` 1,86,425]

21. Prepare the trading and profit and loss account and balance sheet of Chandra as at 31st Dec., 2014. From the following trial balance and additional information.

Debit Balance	`	**Credit Balance**	`
Drawings	10,000	Sales	5,20,000
Opening stock	1,00,000	Purchases returns	2,400
Purchases	25,000	Discount	500
Bills receivable	26,400	Sundry creditors	60,000
Sales returns	4,000	Provision for doubtful debts	3,500
Discount	600	Capital	1,42,800
Carriage outwards	1,000		
Salaries	20,000		
Insurance	2,400		
Rent	6,000		
Sundry debtors	90,000		
Income tax	1,800		
Cash and bank	10,000		
Furniture and fittings	10,000		
Bad debts	4,000		
Plant and machinery	1,60,000		
Freight and duty	3,000		
Wages	30,000		
	7,29,200		**7,29,200**

Adjustments:

(i) Stock on 31st Dec., 2014 was valued at ` 1,20,000.
(ii) The provision for bad debts is to be maintained at 5% on sundry debtors.
(iii) Total bad debts is to be written off were ` 6,400.
(iv) Outstanding liabilities were as under: Salaries ` 4,000 and wages ` 6,000.
(v) Rent and insurance paid during the year were for 15 and 18 months respectively.
(vi) Depreciate furniture and fittings by 5% and plant and machinery by 10%.
(vii) Goods costing ` 1,000 were taken by the proprietor for his own use and have been included in the drawings of ` 10,000.

[**Ans:** Gross Profit ` 2,49,400; Net Profit ` 1,90,320; Balance Sheet total ` 3,91,320]

Hint: Goods taken by proprietor for personal use and included in drawings will have no effects.

22. From the following balances as on 31-12-2014, prepare the trading and profit and loss account and a balance sheet.

Debit Balance	`	Credit Balance	`
Capital	15,950	Manufacturing wages	11,500
Creditors:		Power	4,500
Trade	15,000	Rent and insurance	9,950
Expense	3,400	Salaries and general wages	17,200
Rent received	300	Discount received	900
Purchase returns	2,000	General expenses	4,300
Sales	1,44,800	Sales returns	300
Reserve for doubtful debts (1-1-14)	300	Salesmen commission	1,445
Advertisement development	4,000	Discount allowed	2,500
Goodwill	2,500		
Plant and machinery	10,000		
Samples	1,350		
Stock on hand (1-1-14)	16,000		
Debtors	7,300		
Cash at bank	1,000		
Cash in hand	55		
Drawings	2,500		
Purchases	85,500		
Carriage inwards	750		

Adjustments:

(i) The closing stock was ` 11,500 but there had been a loss by fire on Dec., 2010 not covered by insurance, amounting to ` 10,000.
(ii) Depreciation of 10% on plant and machinery and 33 1/3% on samples has to be written off.
(iii) Reserve for doubtful debts is to be increased to ` 1,000.
(iv) Write-off 50% of advertisement development account.
(v) Annual insurance premium expiring on 31-3-15 was ` 600.

[**Ans:** Gross Profit ` 49,750; Net Profit ` 1,555; Balance Sheet total ` 33,405]

23. From the following balances extracted from the books of Mr. Rahim, prepare Manufacturing account and Trading account for the year ending 31-12-14.

Particulars	`	Particulars	`
Opening Stock: (1-1-14)		Manufacturing wages	37,600
Raw materials	8,000	Motive power	4,000
Work-in-progress	32,000	Oil, grease, water, etc.	1,000
Finished goods	10,000	Heating and Lighting	800
Purchases:	84,000	Factory rent	800
Raw Materials	20,000	Factory insurance	400
Finished goods	2,000	Carriage and fright on finished	600
Sales returns	4,000	goods	200
Carriage inwards	3,000	Octroi (Material)	200
Freight on purchases	9,000	Octroi (Finished goods)	4,000
Import duty	2,400	Closing Stock (31-12-03)	24,000
Dock charges	2,52,000	Raw materials	12,000
Sales	4,000	Work-in-progress	
Purchase returns		Finished goods	

[**Ans:** Cost of finished goods ` 1,55,200; Gross Profit ` 76,000]

24. The following information is given to you from the books of a manufacturer in respect of the year ended 31-3-14.

Debit Balance	`	Credit Balance	`
Stock of raw materials (1-4-13)	50,000	Bank interest received	5,200
Freight Inward	17,000	Electricity and telephone	12,000
Freight Outward	12,000	Selling Expenses	
Wages Direct	36,000	Miscellaneous Expenses	12,000
Wages Indirect	28,000	Stock of Raw	
Sales	8,36,000	Materials (31-3-14)	28,000
Stationery	3,000	Stock of finished goods:	44,000
Travelling expenses	10,000	Opening	60,000
Salaries (H.O)	52,000	Closing	80,000
Factory expenses	52,000	Provision for doubtful debts	17,000
Interest on loan paid	3,600	Depreciation on plant	8,000
Returns Inward	10,000	Depreciation on office furniture	
Return outward	7,000	& equipment	6,000
Power and fuel	16,000	Repairs to plant and machinery	9,300
Coal consumed	18,000	Scrap sales	7,400
Work-in-Progress (1-4-13)	14,000	Purchase of raw materials	5,00,000
Work-in-Progress (31-3-14)	8,000		
	40,500		**40,500**

Additional Information:

(i) Finished goods worth ` 10,000 were distributed as free samples.

(ii) Stock of stationery in hand (31-3-14) ` 300.

(iii) A fire occurred destroying finished goods worth ` 30,000. Insurance Company admitted a claim of ` 24,000 not yet received.

(iv) Electricity and telephone to be apportioned as factory 3/5th and office 2/5th.

(v) Bad debts to be written off ` 1,500 and provision for doubtful debts to be maintained at ` 14,000.

(vi) A loan was sanctioned on 1st Oct., 2013 for ` 1,00,000 carrying interest @ 10% p.a.

You are required to prepare the manufacturing account and Trading and Profit and Loss account for the year ended 31st March, 2014.

[**Ans:** Cost of goods produced ` 6,89,100;]

OBJECTIVE TYPE QUESTIONS

Multiple Choice Questions

1. Loss by Fire is credited to ———————.
   (a) P & L A/c (b) Trading A/c
   (c) Fire A/c (d) Balance Sheet
2. Bad debt is debited to ———————.
   (a) Trading A/c (b) Bad Debt A/c
   (c) P & L A/c (d) Balance Sheet
3. Repair to Machine is ———————-.
   (a) Capital Expenditure (b) Deferred Revenue Expenses
   (c) Revenue Expenses (d) None
4. Interest on Drawing is added to ___________.
   (a) Profit (b) Loss
   (c) Drawing (d) Capital
5. Manufacturing A/c is prepared to find out __________.
   (a) Lost of Production (b) Gross Profit
   (c) Net Profit (d) Financial Position

[**Ans:** (i) (b), (ii) (c), (iii) (c), (iv) (c), (v) (a)]

Match the column

Group A	Group B
1. Revenue Expenditure	(a) Expenditure which is carried forward
2. Deferred Expenditure	(b) Reduction in value of machine .
3. Income Received in Advance	(c) Asset
4. O/s Expense	(d) Liability
5. Carriage Outward	(e) Depends upon wages and salary of individual
6. Contribution to PF	(f) P & L A/c Dr

[**Ans:** 1. (b), 2. (a), 3. (d), 4. (c), 5. (f), 6. (e).]

State whether the following statements are True or False

1. Purchase of Machinery is a Deferred Revenue Expenditure.
2. Carriage Inward is debited to Trading A/c and Carriage outward is credited to P & L A/c.
3. Trial Balance is a Personal A/c.
4. Creditors A/c gives total purchase made during year.
5. Heavy Expenses incurred on advertising at the time of introducing a new product is deferred Revenue Expenditure.

   [**Ans:** 1. False, 2. False, 3. False, 4. False, 5. True.]

CHAPTER 9

Final Accounts of Companies

INTRODUCTION

The joint stock companies, are legally required to prepare a set of financial statements to periodically assess the profits earned and to know the financial position of the company as on a specified date. Thus, as in the case of other business enterprises, a limited company prepares the Income Statement and the Balance Sheet. However, in the case of companies registered under the Companies Act, the Act specifies the books of accounts to be maintained and also prescribes the format and content of the financial statements. In addition, the accounts must be statutorily audited by an external person called the auditor and it is the duty of the auditor to submit a report in the prescribed format to the shareholders.

Since the owners or shareholders elect a Board of Directors to manage the company and rely on the ability and skills of these directors to conduct the business in the most profitable manner, the Companies Act tries to protect the shareholders' interest by prescribing a set of covenants according to which the financial statements are to be prepared and presented to the shareholders. The objective of the Companies Act in laying down various provisions with respect to accounts and audit is to ensure that adequate information is provided to the shareholders in order for them to judge the performance of the directors during an accounting period. The legal requirements laid down by the Companies Act, therefore, assume a great importance in the preparation of the financial statements of a joint stock company.

Component of Financial Statement

Financial statements comprise a number of statements prepared at end of each financial year to assess the various financial activities and strength of an enterprise.

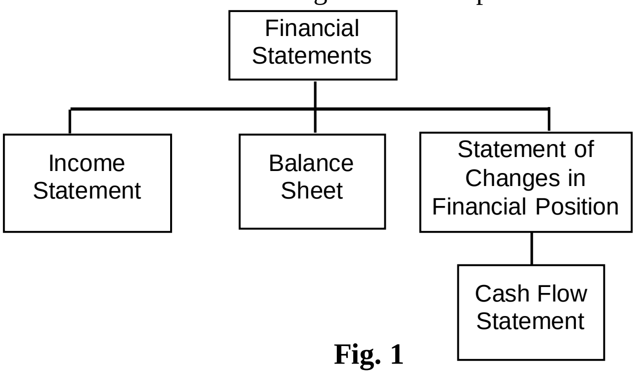


Fig. 1

Financial Statements Components	Source/Type of Companies
Profit and Loss Account Schedule and Notes Forming Part thereto	Under section 210(1) of the companies Act in accordance with the provisions of the Companies Act and the Indian GAAP, to prepared by all the companies. As per Section 211(3B), all applicable accounting standards should be followed. Otherwise reasons of departure from accounting standards and financial effect should be disclosed. Compliance with accounting standards without any deviation is mandatory for the listed companies as per clause 50 of the Listing Agreement vide SEBI Circulars SMRP/Policy/Cir-44/01, Aug 31, 2001.
Cash Flow Statement	As per clause 32 of the Listing Agreement vide SEBI circular SMD-n Policy/Cir-80/2000 Feb. 4, 2000. Cash Flow Statement should be prepared in Accordance with the requirements of AS-3 issued by the ICAI. To be prepared by listed companies.
Consolidated Financial Statements	Applicable to listed companies as per the SEBI circular SMRP/Policy/Cir-44/01, Aug. 31, 2001. Companies listed in a recognized stock exchange shall be mandatorily required to publish Consolidated Financial Statements, in the annual report in addition to the individual financial statements shall be mandatory. To be prepared in accordance with AS-21 and AS-23. Section 217 (2AA) requires that board's Report shall include a Director's Responsibility Statement in which it is to be indicated that in the preparation of annual accounts, the applicable accounting standards are followed.

Framework

The conceptual framework for Financial Reporting issued by the IASB has stated the following uses of the general purpose financial statements by the cross-section of users:

(a) To decide when to buy, hold or sell any equity investment,

(b) To assess the accountability of management,

(c) To assess the ability of the entity to pay and provide other benefits to its employees,

(d) To assess the security for amounts lent to the entity,

(e) To determine taxation policies,

(f) To determine distributable profits and dividends,

(g) To prepare and use national income statistics,

Important shortcoming of financial statements is that they are prepared to meet the common information needs of a wide range of users. They may fall short of specific information needs of the users.

To meet the above-stated uses, financial statements provide information about an entity's assets, liabilities, equity, and income and expenses, including gains and losses, other changes in equity and cash flows. That information, along with other information in the notes, assists users of financial statements in predicting amount, timing and degree of certainty of the entity's future cash flows.

Applicability: In terms of powers conferred u/s 641 (1) of the Companies Act, 1956, the Central Government replaced Existing Schedule VI.

Date of enforcement of Schedule VI (Revised): 01/04/2011

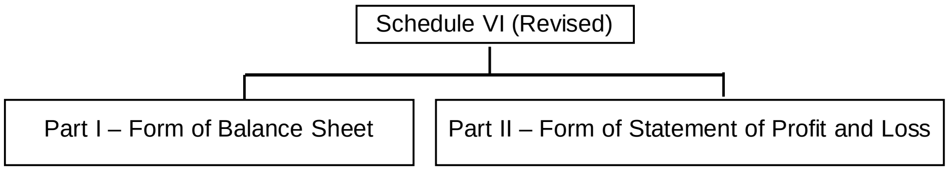


Fig. 2

Part I - Form Balance Sheet

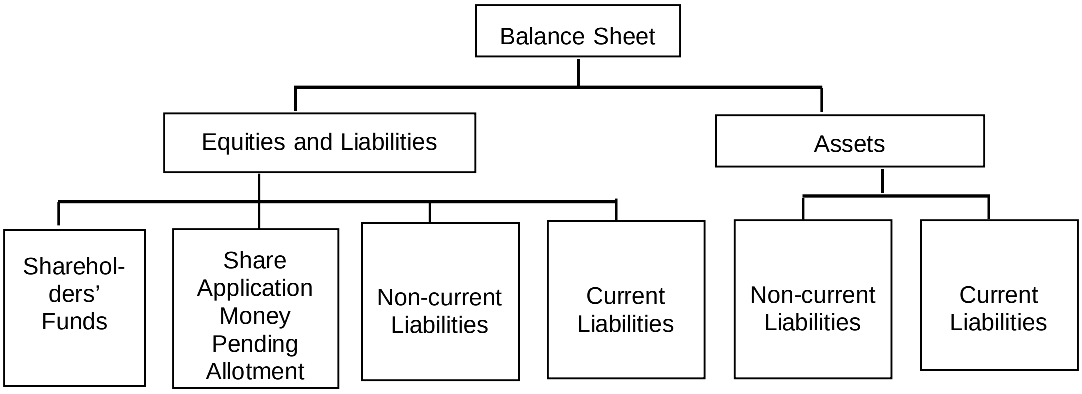


Fig. 3

Break-up of Equities and Liabilities

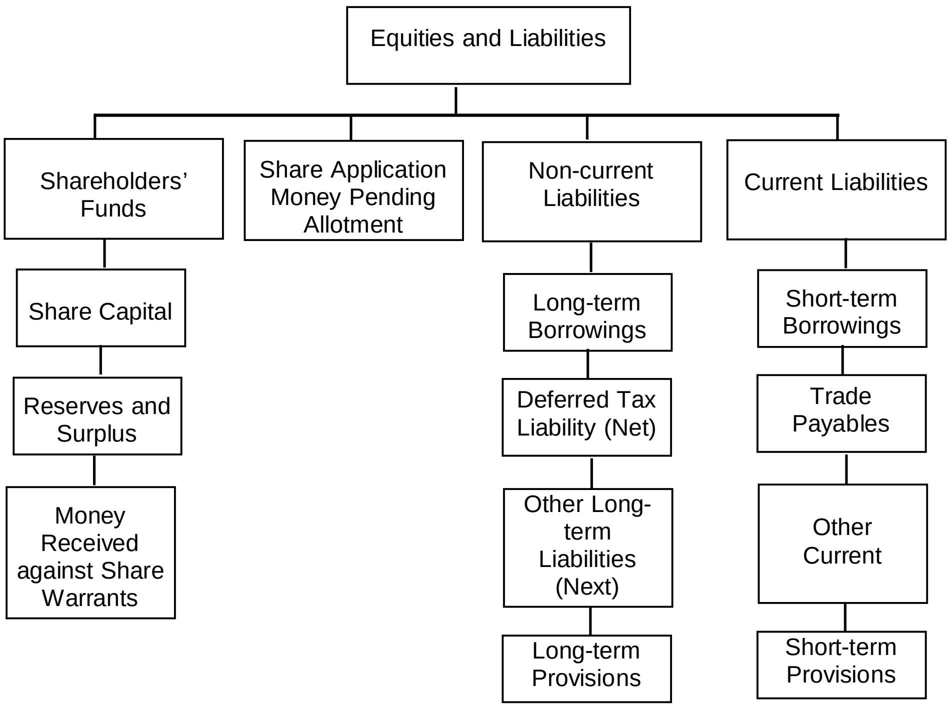


Fig. 4

Break-up of Assets

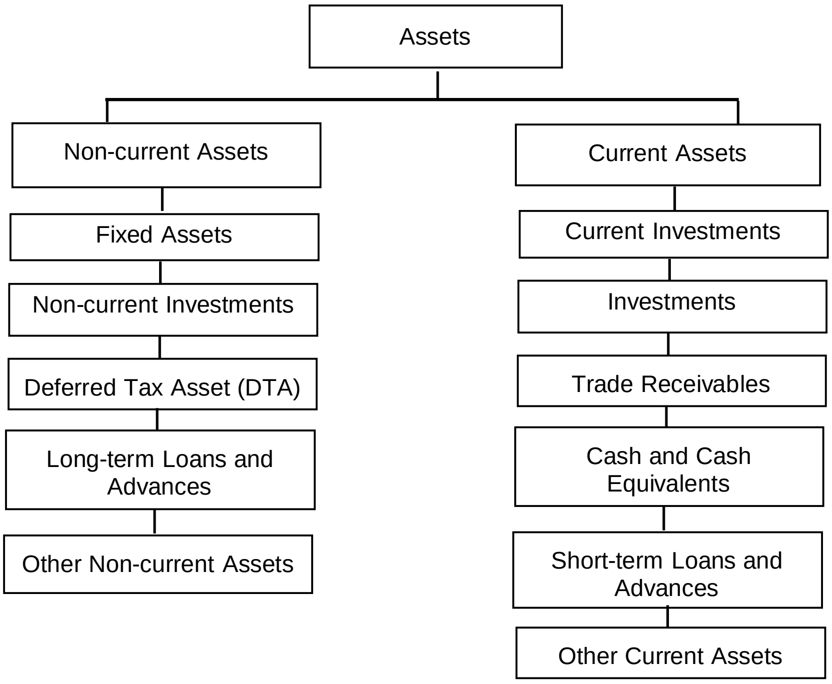


Fig. 5

PART - I: FORM OF BALANCE SHEET

Name of the Company: ____________________________

Balance Sheet as at: ______________________________

Particulars	**Note**	**Figure as at the End of Current Reporting Period**	**Figure as at the End of the Previous Reporting Period**
I. Equity and Liabilities:			
1. Shareholders' Funds			
(a) Share Capital			
(b) Reserves and Surplus			
(c) Money Received against Share Warrants			
2. Share Application Money Pending Allotment			
3. Non-current Liabi1ilies:			
(a) Long-term Borrowings			
(b) DTL (Net)			
(c) Other Long-term Liabilities			
(d) Long-term Provisions			

(4) Current Liabilities: (a) Short-term Borrowings (b) Trade Payables (c) Other Current Liabilities (d) Short-term Provisions **Total** **(II) Assets:** 1. Non-current Assets: (a) Fixed Assets: (i) Tangible Assets (ii) Intangible Assets (iii) Capital WIP (iv) Intangible Assets under Development (b) Non-current Investment (c) DTA (Net) (d) Long-term Loans and Advances (e) Other Non-current Assets 2. Current Assets (a) Current Investments (b) Inventories (c) Trade Receivables (d) Cash and Cash Equivalents (e) Short-term Loans and Advances (f) Other Current Assets			

For the purpose of this Schedule, the terms used herein shall be as per the applicable Accounting Standards.

Notes to Balance Sheet A Company shall disclose the following in the Notes to Accounts – Details provided.

Disclosure Requirement: Schedules Forming Part of Financial. Statements/Annual Report.

(A) For "Equity and Liabilities" Items

(1) Shareholders' Funds

(a) Share Capital

Example: Reporting Authorized, Issued, Subscribed, Called up and Paid-up Capital including forfeited shares:

Authorized Capital: Equity Share ` 1,00,000 shares @ ` 100 each ` 1,00,00,000. Preference Share Capital 15% Redeemable Preference shares, ` 50,000. Shares ` 50,000 Shares @ ` 100 each = ` 50,00,000. Debt 18%, Convertible Preference Shares, ` 30,000 Shares @ ` 100 each = ` 30,00,000.

Issued Capital: Equity Share 30,000 Shares @ ` 100 each, fully paid up = ` 30,00,000; 19,800 Equity Shares of ` 100 each, ` 80 called up and paid up = ` 15,84,000. Amount received on 200 shares forfeited from non-payment of allotment and first call of ` 30 and ` 40 each, final call was not made on those shares, Amount payable on application ` 10 per share. Preference Share Capital: 15%

Redeemable Preference ares, 10,000 Shares @ ` 100 each = ` 10,00,000. 18%, Convertible. Preference Shares, 20,000 shares @ ` 100 each = ` 20,000.

How will this shown in the Working/Schedules, assuming first year of operation?

Solution

(1) Share Capital

(1) (a) Authorized Capital:

Particulars	Current Year	Previous Year
Equity Share 1,00,000 Shares @ ` 100 each 15%, 50,000 Redeemable Preference Shares @ ` 100 each 18%, 30,000 Convertible Preference Shares @ ` 100 each	1,00,00,000 50,00,000 30,00,000	
Total	**1,80,00,000**	

(1) (a) Issued Capital:

Particulars	Current Year	Previous Year
Equity Share 50,000 Shares @ ` 100 each 15%, 10,000 Redeemable Preference Shares @ ` 100 each 18%, 20,000 Convertible Preference Shares @ ` 100 each	50,00,000 10,00,000 20,00,000	
Total	**80,00,000**	

(1) (c) Subscribed Called up and Paid-up Capital:

Particulars	Current Year	Previous Year
(i) 30,000 Equity Share @ ` 100 each, fully paid up	30,00,000	
(ii) 19,800 Equity shares @ ` 100 each, ` 80 called up and paid up	15,84,000	
(iii) 15%; 10,000 Redeemable Preference Shares @ ` 100 each	10,00,000	
(iv) 15%, 20,000 Convertible Preference Shares @ ` 100 each	20,00,000	
Add: Forfeited Shares (amount originally paid-up)		
	75,84,000	
	2,000	
Total for Balance Sheet	**75,86,000**	

(1) (d) Reconciliation of Number and Amount of Shares:

(i) For Equity Shares

Particulars	Current Year		Previous Year	
	No. of Shares	**`**	**No. of Shares**	**`**
Opening Balance as on 01/04/2011	Nil	Nil	Nil	Nil
Add: Fresh Issue (Including Bonus shares, Right Shares, Split of Shares, Shares issued otherwise than for cash as a purchase consideration)	49,800	45,84,00	Nil	Nil
Sub Total	49,800	45,84,000	Nil	Nil
Less: Buyback of shares	Nil	Nil	Nil	Nil
Closing balance as on 31/3/2012	49,800	45,84,000	Nil	Nil

(ii) For Preference Shares

(a) For 15% Redeemable Preference Shares of ` 100 each

Particulars	Current Year		Previous Year	
	No. of Shares	**`**	**No. of Shares**	**`**
Opening Balance as on 01/04/2011	Nil	Nil	Nil	Nil
Add: Fresh Issue (Including Shares issued otherwise than for cash as a purchase consideration)	10,000	10,00,000	Nil	Nil
Sub Total				
Less: Redemption of shares	10,000	10,00,000	Nil	Nil
Closing balance as on 31/03/2012	Nil	Nil	Nil	Nil
	10,000	10,00,000	Nil	Nil

(b) For 18% Convertible Preference Shares of ` 100 each

Particulars	Current Year		Previous Year	
	No, of Shares	**`**	**No, of Shares**	**`**
Opening Balance as on 01/04/2011	Nil	Nil	Nil	Nil
Add: Fresh Issue	20,000	20,00,00	Nil	Nil
Sub Total	20,000	20,00,00	Nil	Nil
Less: Redemption/Buyback of shares	Nil	Nil	Nil	Nil
Closing balance as on 31/03/2012	20,000	20,00,000	Nil	Nil

3. Non-current Liability

(3) (a) Long-term Borrowing:

Schedule VI Disclosure Requirement	Points
Long-term Borrowings shall be classified as: (a) Bonds/Debentures	
(b) Terms Loans: (i) from Banks, and (ii) from Other Parties.	Loans with repayment period beyond 36 months are usually known as "Term Loans". So, Cash Credit, Overdraft and Call Money Accounts/ Deposit are not covered by the expression "Term Loans".
(c) Deferred Payment Liabilities	Deferred Payment Liabilities, would include any Liability for which payment is to be made on deferred credit Deferred Sales Tax Liability, Deferred Payment for Acquisition of fixed Assets, etc.
(d) Deposits	Deposits classified under Borrowings would include Deposits accepted from Public and Inter-corporate Deposits which are in the nature of Borrowings.
(e) Loans and Advances from Related Parties	Loans and advances from related parties are required to be disclosed. Advances under this head should include those advances which are in the nature of loans.
(f) Long-term Maturities of Finance Lease Obligations	
(g) Other Loans and Advances (specify nature)	

(3) (b) Deferred Tax Liabilities: **(Also Refer AS-22)**

Schedule VI Disclosure Requirement	Points
To be shown as a separate line item on the face of Balance Sheet:	–

(3) (c) Other Long-term Liabilities:

Schedule VI Disclosure Requirement	Points
It shall be classified as: (a) Trade Payables	Sundry Creditors for Goods or Services, and Acceptances should be disclosed as part of Trade Payables. Disclosure Requirements under MSMED Act will also be required to be made in the annual Financial Statements.
(b) Others	Amounts due under contractual obligations, *e.g.*, payables in respect of statutory obligations like contribution to Reimbursable Expenses, Interest Accrued on Trade Payables, etc. should be classified as "Others" and each such item should be disclosed nature-wise.

(3) (d) Long-term Provisions

Schedule VI Disclosure Requirement	Points
It shall be classified as: (a) Provisions for Employee Benefits	This should be classified into short-term and long-term portions, and the latter amount should be included here.
(b) Others (specify nature)	This would include items like Provisions for Warranties, etc.

4. Current Liabilities:

(4) (a) Short-term Borrowings

Schedule VI Disclosure Requirement	Points
(1) Short-term Borrowings shall be classified as: Loans repayable on demand (i) from banks, and (ii) Other parties Loans and advances from related parties Deposits Others loans and advances (specify nature)	Short-term borrowings will include all loans within a period of 12 months from the date of will not include current maturity of long-term borrowings (which should be treated only as "Other Current Liabilities"). In case of short-term borrowings all defaults (not continuing defaults as in the case of long-term borrowings) existing as at the date of the balance sheet should be disclosed item wise. A 3-year Loan taken for a business with an 4-year operating cycle will be categorized only as short-term borrowings, and not as long-term borrowings.
(2) Security-wise classification: Borrowings shall further be sub-classified as secured and unsecured Nature of security shall be specified separately in each case.	

(4) (b) Trade Payables:

Schedule VI Disclosure Requirement	Points
To be shown as a separate line item on the face of balance sheet:	Refer to meaning of trade payable give earlier. **Liability for capital goods purchases:** Amount due towards purchase disclosed under other current liabilities with a suitable description. **Liability under contractual obligations:** Liability towards employees, leases or other contractual liabilities should not be included under trade payables only "Commercial dues" can be included under trade payables.

(c) Other Current Liabilities

Schedule VI Disclosure Requirement	Points
It shall be classified as: (a) Current maturities of Long-term Debt (b) Current Maturities of Finance Lease Obligations (c) Interest Accrued and due on Borrowings	The portion of Long Term Debts/Lease Obligations, which is due for payments within 12 months of the reporting date is required to be classified under "Other Current Liabilities",

(d) Income Received in Advance (e) Unpaid Dividends (f) Application money received for Allotment of Securities and due for Refund and Interest Accrued thereon (Refer Note below) (g) Unpaid Matured Deposits and Interest Accrued thereon (h) Unpaid Matured Debentures and Interest Accrued thereon (i) Other Payables (specify nature)	while the balance amount should be classified under Long-term Borrowings. Trade Deposits and Security Deposits which are not in the nature of borrowings should be classified separately under Other Non-current/Current Liabilities. **Other Payables** under this head may be in the nature of statutory dues such as Withholding Taxes, Services Tax, VAT, Excise Duty, etc. **Current Year Classification as Current Liability and Previous Year Non-current Liability:** Current/Non-current Classification of Assets/Liabilities is determined a particular date, *i.e.*, Balance Sheet date. So, if there is any change in the position at the end of the current year resulting in a different classification of Assets/Liabilities in the current year, it will **not** impact the classification made in the previous year.

Notes:

1. Share Application Money includes Advance towards allotment of Share Capital.
2. Terms and Conditions including the Number of Shares proposed to be issued, the Amount of Premium if any, and the period before which shares shall be allotted shall be disclosed.
3. It shall also be disclosed whether the Company has sufficient Authorized Capital to cover the Share Capital Amount resulting from Allotment of Shares out of such Share Application Money.
4. Further, the period for which the Share Application Money has been pending beyond the period for allotment as mentioned in the document inviting application for shares along with the reason for such Share Applications Money being pending shall be disclosed.
5. Share Application Money not exceeding the Issued Capital and to the extent not refundable shall be shown under the head 'Equity' and Share Application Money to the extent refundable, *i.e.*, the amount in excess of subscription or in case the requirements of minimum subscription are not met, shall be separately shown under **"Other Current Liabilities".**

(d) Short-term 'Provisions:

Schedule VI Disclosure Requirement	Points
It shall be classified as: (a) Provision for Employee Benefits	This should be classified into short-term and long-term Portion, and the former amount should be included here.
(b) Others (specify nature)	This includes Provision for Dividend, Provision for Taxation Provision for Warranties, etc

(e) Disclosure Requirements for "Assets" Items

(1) Non-current Assets:

(1) (a) (i) Tangible Assets **(Also Refer AS-6, 10)**

Schedule VI Disclosure Requirement	Points
1. Classification shall be given as: (a) Land, (b) Buildings, (c) Plant and Equipment, (d) Furniture and Fixtures, (e) vehicles, (f) office Equipment, (g) Other (specify nature)	AS-19 excludes land leases from its scope. **Leasehold Land** should be presented as a separate assets class under **Tangible Assets**. Also, freehold land should be presented as a separate assets class.
2. Assets under **Lease** shall be separately specified under each class of Asset.	The term "under lease" should mean-(a) Assets given on Operating Lease in the case of Lessor, and (b) Assets held under Finance Lease in the case of Leassee. Leasehold Improvements should continue to be shown as a separate asset class.
3. Revaluation: Where sums have been written off on a Reduction of capital or Revaluation of Assets of where sums have been added on Revaluation of Assets, every Balance Sheet subsequent to date of such, write-off, of addition shall show the Reduced or Increased figures as applicable and shall be way of a Note also show the amount of the Reduction or Increase as applicable together with the date thereof for the first 5 years subsequent to the date of such Reduction or Increase.	AS - 10 requires disclosure of details such as Gross Book Value of Revalued Assets, Method adopted to compute revalued amounts, Nature of indices used, Year of appraisal, Involvement of External Valuer, etc. **as long as the concerned assets are held** by the Enterprise. [but only 5 years period is specified in Schedule VI (R)]. AS - 10 requirements will prevail. [**Note:** AS - 26 does not permit revaluation of Intangible Assets.
4. Reconciliation: A Reconciliation of the Gross and Net Carrying Amounts of each Class of Assets at the Beginning and End of the Reporting period showing Additions, Disposals, Acquisitions through Business Combinations and other Adjustments and the related Depreciation and Impairment Losses/Reversals shall be disclosed separately.	(a) Since reconciliation of Gross and Net Carrying Amounts of Fixed assets is required, the Depreciation/Accounts of fixed assets is required, the Depreciation/Amortization for each class of asset should be disclosed in terms of 1. Opening Accumulated Depreciation. 2. Depreciation/Amortization for the year, 3. Deduction/Other Adjustments, and 4. Closing Accumulated Depreciation/ Amortization (b) Similar disclosures should also be made for Impairment, if any, as applicable. (c) **Business Combinations:** Business Combination should be taken as an amalgamation or acquisition or any other mode of restructuring of a set of Assets and/or a group of Assets and Liabilities constituting a business. Acquisitions through 'Business Combinations' should be disclosed separately for each class of assets.

	Assets Disposals through Demergers, etc. any also be disclosed separately for each class of assets. (d) **Other Adjustments:** This includes: Capitalization of FOREX Differences where such option has been exercised by the Company as per AS-11. Adjustments on a/c of Exchange Fluctuations for Fixed Assets in case of Non-integral Operations (AS-11). Borrowing Costs capitalized as per AS-16.

(1) (a) (ii) Intangible Assets: **(Also Refer AS-26)**

Schedule VI Disclosure Requirement	Points
Classification shall be given as: (a) Goodwill, (b) Brands/Trademarks, (c) Computer Software, (d) Mastheads and Publishing Titles, (e) Mining Rights, (f) Copyrights, and Patents and Other Intellectual Property Right, Services and Operating Rights, (g) Recipes, Formulae, Modes, Designs and Prototypes, (h) Licenses and Franchise, (i) Other (specify nature)	Classification of Intangible Assets has been introduced under Schedule VI(R). Intangible Assets Under development should also be disclosed separately, if AS-26 and criteria are met.

Note: Points 3 and 4 of Tangible Assets is also applicable for Intangible Assets.

(1) (a) (iii) Capital Work-in-progress:

Schedule VI Disclosure Requirement	Points
To be shown as a separate line item on the face of Balance Sheet	**Capital Advances** should be included under Long-term Loans and Advances and hence, cannot be included under Capital WIP.

(1) (a) (iv) Intangible Assets Under Development:

Schedule VI Disclosure Requirement	Points
To be shown as a separate line item on the face of Balance Sheet	Intangible Assets under development should be disclosed under this head provided they can be recognized based on the criteria laid down in AS-26

(1) (b) Non-current Investments: **(Also Refer AS-13)**

Schedule VI Disclosure Requirement	Points
Non-current Investments shall be classified as Trade Investments and Other Investments, and further classified as Investments in: (a) Property (b) Equity Instruments (c) Preferences Shares (d) Government/Trust Securities	If a debenture is to be redeemed partly within 12 months and balance after 12 months the amount to be redeemed within 12 months should be disclosed as current, and balance as non-current. **"Trade Investment"** is normally understood as an Investment made by a company in shares or debentures of another company to promote the trade or business of the first company.

(e) Debentures or Bonds (f) Mutual Funds (g) Partnership Firms, and (h) Other Non-current Investments (specify nature)	
(1) Investments carried at other than at Cost should be separately stated specifying the basis for valuation thereof.	**Basis of Valuation:** Disclosure for basis of valuation of Non-current Investments may be either of – (a) Cost or (b) Cost less Provision for other than temporary diminution or (c) Lower of Cost and Fair Value.
(2) The following shall also be disclosed: (a) Aggregate amount of Quoted investments and Market Value thereof. (b) Aggregate Amount of Unquoted investments. (c) Aggregate Provision for Diminution in value of Investments.	It is recommended to disclose the amount of provision netted-off for each Long-Term Investment. However, the aggregate amount of provision made in respect of all Non-Current Investment should also be separately disclosed to comply with the specific disclosure requirement in Schedule VI(R).

(1) (c) Deferred Tax Assets: (Also Refer AS-22)

Schedule VI Disclosure Requirement	Points
To be shown as a separate line item on the face of Balance Sheet	

(1) (d) Long-term Loans and Advances:

Sch. VI Disclosure Requirement	Points
1. General Classification: Long Term Loans and Advances shall be classified as: (a) Capital Advances, (b) Security Deposits, (c) Loans and Advance to Related Parties (giving details thereof), (d) Other Loans and Advance (Specify nature)	**Capital Advances:** It should be specifically included under Long-term Loans and Advance and hence, cannot be included under Capital Work-In Progress. Capital Advances are advances given for procurement of Fixed Assets which are Non-current Assets. They are not realized back in cash, nut over a period, get converted into fixed assets. Assets, Hence, they are always Long term advance, irrespective of when the fixed Assets are expected to be recd. **Other Loans and Advances** should include all other items in the nature of advances recoverable in cash or kind, *e.g.*, Prepaid expenses, advances tax, CENVAT Credit Receivable, VAT Credit Receivable service tax Credit Receivable, etc. which are not expected to be realized within the next 12 months or operating cycle whichever is longer from the Balance Sheet date.
(2) Security-wise Classification: The above shall be separately sub-classified as: (a) Secured, considered good	

(b) Unsecured, considered good (c) Doubtful	
(3) Bad/Doubtful: Allowance for Bad and Doubtful Loans and advances shall be disclosed under the relevant heads separately.	
(4) Directors, etc.: Loans and Advances due by Directors or other officers of the company or any of them either severally or jointly with any other persons or amounts due by Firms or Private Companies respectively in which any Director is a Partner of a Director of a Member should be separately stated.	The term "Details" of Loans and Advances of related parties would mean disclosure requirements contained in AS-18.

(1) (e) Other Non-current Assets:

Schedule VI Disclosure Requirement	Points
(1) **Other Non-current Assets** shall be classified as: (a) Long-term Trade Receivables (including Trade Receivables on Deferred Credit Terms) (b) Others (specify nature)	A Receivable shall be classified as 'Trade Receivable' if it is in respect of the amount due on account of good sold or services rendered in the normal course of business. Dues in respect of Insurance Claims, Sale of Fixed Assets, Contractually Reimbursable Expenses, Interest Accrued on Trade Receivables, etc. should be classified as **"Others"** and each such item should be disclosed nature-wise.

(2) Current Assets

(2) (a) Current Investments: **(Also Refer AS-13)**

Schedule VI Disclosure Requirement	Points
Current Investments shall be classified as: 1. Investments in Equity Instruments 2. Investment in Preference Shares 3. Investments in Government or Trust Securities 4. Investments in Debentures or Bonds 5. Investments in Mutual Funds 6. Investments in Partnership Firms 7. Other Investments (specify nature)	Principles given for Non-current Investments will apply here, to the extent relevant. However, Trade vs. Non-trade Classification, is not required for Current Investments.

Notes

1. Under each classification, details shall be given of Names of Bodies Corporate [indicating separately whether such Bodies are: (i) Subsidiaries, (ii) Associates, (iii) Joint Ventures, or (iv) Controlled Special Purpose Entities] in whom Investments have been made and the nature and extent of the Investment so made in each such Body Corporate (showing separately investments which are party paid). In regard to Investments in the Capital of Partnership Firms, the names of the Firms (with the names of all their Partners, Total Capital and the Shares of each Partner) shall be given.
2. The following shall also be disclosed:
   (a) Basis of Valuation of individual Investments,

(b) Aggregate Amount of Quoted Investments and Market Value thereof,

(c) Aggregate Amount of Unquoted Investments,

(d) Aggregate Provision made for Diminution in Value of Investments.

(2) (b) Inventories: **(Also Refer AS-2)**

Schedule VI Disclosure Requirement	Points
Inventories shall be classified as: 1. Raw materials 2. Work-in-progress 3. Finished Goods, 4. Stock-in-trade (in respect of goods acquired for Trading) 5. Stores and Spares 6. Loose Tools 7. Others (specify nature)	Goods in Transit should be included under relevant heads with suitable disclosure. The heading "Finished Goods" should comprise of all Finished Goods other than those acquired for trading purposes. Those acquired for trading purposes are to be shown under "Stock in Trade".

Note: Goods-in-transit shall be disclosed under the relevant sub-head of Inventories. Mode of Valuation shall be stated.

(2) (c) Trade Receivables:

Schedule VI Disclosure Requirement	Points
1. Aggregate amount of Trade Receivables outstanding for a period exceeding 6 months from the date they are due for payment should be separately stated. **2. Security-wise Details:** Trade Receivables shall be separately sub-classified as: (a) Secured, considered Good (b) Unsecured, considered Good (c) Doubtful	Where no due date is specifically agreed upon, normal credit period allows by the Company should be taken into consideration for computing the due date, which may vary depending upon the nature of goods or services sold and the type of customers, etc.
(3) Bad/Doubtful: Allowance for Bad and Doubtful Loans and Advances shall be disclosed under the relevant heads separately	Amounts due under contractual obligations, *e.g.*, dues in respect of Insurance Claims, Sale of Fixed Assets, Contractually Reimbursable Expenses, Interest Accrued on Trade Receivables, etc, cannot be included within Trade Receivables, etc. cannot be included within Trade Receivables, such Receivables should be classified as "**Other, Current Assets"** and each such item should be disclosed nature-wise.
(4) Directors, etc.: Debts due by Directors or Other Officers of the Company or any of them either severally or jointly with any other person or debts due by Firms or Private Companies respectively in which any Director or a Member should be separately stated.	**Lean Period Activities:** Receivables arising out of sale of materials/rendering of services during a company's lean period, should be included under "Trade Receivables", if such activity is in the normal course of business. If they are not part of "normal course of business", they are to be classified under "**Other Assets".**

(2) (d) Cash and Cash Equivalents **(Also Refer AS-3)**

Schedule VI Disclosure Requirement	Points
Cash and Cash Equivalents shall be classified as: (a) Balance with Banks (b) Cheques, Drafts on Hand (c) Cash on Hand (d) Other (specify nature)	"Other Bank Balances" would comprise items like Balance with Banks to the extent of held as Margin Money or Security against Borrowings etc. and Bank Deposits with more than 3 months maturity.

Notes:

1. Earmarked Balance with Banks (*e.g.*, for Unpaid Dividend) shall be separately stated.
2. Bank Deposits with more than 12 months' maturity will also need to be separately disclosed under the above subhead.
3. Balances with Banks to the extent held as margin Money or Security against the Borrowings, Guarantees, Other Commitments shall be disclosed separately.
4. The Non-current Portion of each of the above balances should be classified under the head "Other Non-current Assets" with separate disclosure thereof.
5. Repatriation restrictions, if any, in respect of Cash and Bank Balances shall be separately stated.
6. Bank Deposits with more than 12 months' maturity shall be disclosed separately.

(2) (e) Short-term Loans and Advances:

Schedule VI Disclosure Requirement	Points
(1) General Classification: Short-term Loans and Advances shall be classified as: (a) Loans and Advances to Related Parties (giving details thereof) (b) Others (specify nature) (2) Security-wise Classification: The above shall also be sub-classified as: (a) Secured, considered good (b) Unsecured, considered good (c) Doubtful (3) Bad/Doubtful: Allowance for Bad and Doubtful Loans and Advances shall be disclosed under the relevant heads separately. (4) Directors, etc.: Loans and Advances due by Directors or Other Officers of the Company or any of them either severally or Jointly with any other person or amounts due by Firms or Private Companies respectively in which any Director is a Partner or a Director or a Member shall be separately stated.	Principles given for Long-term Loans and Advances will apply here, to the extent relevant. .

(2) (f) Other Current Assets:

Schedule VI Disclosure Requirement	Points
This is an all-inclusive heading, which incorporates Current Assets that do not fit into any other Assets Categories. Nature of each item should be specified.	This is an **all-inclusive heading,** which incorporates Current Assets that do not fit into any other asset categories, *e.g.*, Unbilled Revenue, Unamortized premium on Forward Contracts, etc. In case any amount classified under this category is doubtful, it is advisable that such doubtful amount as well as any provision made there against should be separately disclosed.

Special Point: Unamortized Portion of Share Issue Expenses, etc.

1. Schedule VI(R) does not contain any specifies disclosure requirement for the unamortized portion of expenses items such as Share Issue Expenses, Ancillary Borrowing Costs and Discount or Premium relating to Borrowings.
2. As per AS-16, Ancillary Borrowings Costs and Discount or Premium relating to Borrowings could be amortized over the loan period. Further, share Issue Expenses, Discount on Shares, Ancillary Costs Discount, Premium on Borrowing, etc. being sped nature items, are excluded from the scope of AS-26 Intangible Assets.
3. Certain companies have taken a view that it is an acceptable practice to amortize these expenses over the period of benefit, *i.e.*, normally 3 to 5 years.
4. **Conclusion:** Schedule (R) does not deal with any accounting treatment of these items, and the Same continues to be governed by the respective AS/best practices. So, a company can disclose the Unamortized Portion of such expenses as “Unamortized Expenses”, under the head “Other Current/Non-current Assets”, depending on whether the amount will be amortized in the next 12 months or thereafter.

PART II FORM OF STATEMENT OF PROFIT AND LOSS

Name of the Company: Hero Ltd.
Profit and Loss Statement for the year ended: 31st March, 2012 (` in ‘000’)

Particulars	Note No.		As at 31st March, 2012	As at 31st March, 2011
(i) Revenue from Operation:			XXX	XXX
(ii) Other Income			XXX	XXX
(iii) Total Revenue (I + II)			XXX	XXX
(iv) Expenses:				
Cost of Material Consumed			XXX	XXX
Purchases of Stock-in-Trade			XXX	XXX
Changes in inventories of Finished Goods, Work-in-progress and Stock-in-Trade			XXX	XXX
Employee Benefits Expense				
Finance Costs				
Depreciation and Amortization Expenses				

Other Expenses				
Total Expense			**XXX**	**XXX**
(v) Profit before Exceptional and Extraordinary items and tax (iii – iv)			XXX	XXX
(vi) Exceptional items			XXX	XXX
(vii) Profit before Extraordinary Items and Tax			XXX	XXX
(v – vi)			XXX	XXX
(viii) Extraordinary items			XXX	XXX
(ix) Profit before tax (vii – viii)			XXX	XXX
(x) Tax Expenses:				
(a) Current Tax				
(b) Deferred Tax			XXX	XXX
(xi) Profit/(Loss) for the period from Continuing Operations (ix – x)			XXX	XXX
(xii) Profit/(Loss) from Discontinuing Operations			XXX	XXX
(xiii) Tax Expenses of Discontinuing Operations			XXX	XXX
(xiv) Profit (Loss) from Discontinuing Operations (After Tax) (xii + xiii)			XXX	XXX
(xv) Profit/(Loss) for the period (xi + xiv)			XXX	XXX
(xvi) Earning per Equity Share:				
(a) Basic				
(b) Diluted				

General Instructions for Preparation of Statement of P & L A/c

Item	Description	
1. Sec. 25 Companies	The provisions of this Part shall apply to the Income and Expenditure Account referred to in Sec. 210(2) of the Act, in like manner as they apply to a Statement of Profit and Loss.	
2. Revenue from Operations	**For Company other than a Finance Company:** Revenue from Operations shall disclose separately in the Notes, Revenue from (a) Sale of Products (b) Sale of Services (c) Other Operating Revenues (d) *Less:* Excise Duty	**For Finance Company:** Revenue from Operations shall include Revenue from: (a) Interest (b) Other Financial Services Revenue under each of the above heads shall be disclosed separately by way of Notes to Accounts to the extent applicable.
3. Finance Costs	Finance Costs shall be classified as: (a) Interest Expenses (b) Other Borrowing Costs (c) Applicable Net Gain/Loss on Foreign Currency Transactions and Translation	
4. Other Income	Other Income shall be classified as: Interest Income (in case of a Company other than a Finance Company)	

	(b) Dividend Income (c) Net Gain/Loss on Sale of Investments (d) Other Non-operating Income (Net of Expenses directly attributable to such income)
5. Additional Information	A company shall disclose by way of **Notes, additional Information regarding**.

Aggregate Expenditure and Income on the following items referred below.

(i) Employee Benefits, Expense, Income Items, etc.:

(a) Employee Benefits Expense [showing separately – (i) Salaries and Wages, (ii) Contribution to PF and Other Funds, (iii) Expense on ESOP and Employee Stock Purchase Plan (ESPPI), (iv) Staff Welfare Expenses]

(b) Depreciation and Amortization Expenses

(c) Any item of Income of Expenditure which exceeds 1% of Revenue from Operations or ` 1,00,000 whichever is higher

(d) Interest Income

(e) Interest Expense

(f) Dividend Income

(g) 'Net Gain/Loss on Sale of Investments

(h) Adjustments to the Carrying Amount of Investments

(i) Net Gain/Loss on Foreign Currency Transaction and Translation (other than considered as Finance Cost),

(j) Payments to the Auditor as: (a) Auditor, (b) For Taxation Matters, (c) For Company Law Matters (d) For Management Services, (e) For Other Services, (f) For Reimbursement of Expenses

(k) Item of Exceptional and Exceptional and Extraordinary Nature

(i) Prior Period Items.

(ii) Materials, Goods, Services, etc.

(a) In the case of **Manufacturing Companies:**

1. Raw Materials under broad heads.
2. Goods Purchased under broad heads.

(b) In the case of **Trading Companies,** Purchases in respect of goods traded in by the company under broad heads.

(c) In the case of **Companies rendering or supplying services,** Gross Income derived from Services Rendered or Supplied, under broad heads.

(d) In the case of a Company, which falls under more than one of the categories mentioned in (a), (b) and (c) above, it shall be sufficient compliance with the requirements herein if Purchases, Sales and Consumption of Raw Material and the Gross Income from Services rendered is shown under broad head.

(e) In the case of **Other Companies,** Gross Income derived under broad heads.

(iii) In the case of all concerns having Work-in-Progress, Work-in-Progress under broad heads.

(iv) Reserves – Creation and Utilization:

(a) The aggregate, if materials, of any amounts set aside or proposed to be set aside, to Reserve, but not including Provisions made to meet any Specific Liability, Contingency or Commitment Known to exist at the date as to which the Balance Sheet is made up.

(b) The aggregate, if material, of any amounts withdrawn from such Reserves.

(v) Provision – Creation and Immunization:

(a) The aggregate, if material, of the amounts set aside to Provisions made for meeting Specific Liabilities, Contingencies or Commitments.

(b) The aggregate, if material, of the amounts withdrawn from such provisions as no longer required.

(vi) Expenses, etc: Expenditure incurred on each of the following items, separately for each item:

(a) Consumption of Stores and Spare Parts
(b) Power and Fuel
(c) Rent
(d) Repairs to Buildings
(e) Repairs to Machinery
(f) Insurance
(g) Rates and Taxes, excluding, Taxes on Income
(h) Miscellaneous Expenses.

(vii) Subsidiaries Information:

(a) Dividends from Subsidiary Companies.

(b) Provisions for Losses of Subsidiary Companies.

(viii) FOREX Information: The P & L A/c shall also contain by way of a Note the following Information, namely.

(a) Value of Imports Calculated on **CIF basis** by the Company during the Financial Year in respect of: (I) Raw Materials, (II) Components and Spare Parts, (III) Capital Goods.

(b) Expenditure in Foreign Currency during the Financial Year on account of Royalty, Know-how, Professional and Consultation Fees, Interest, and Other Matters.

(c) Total Value if all **Imported** Raw Materials, Spare Parts and Components consumed during the Financial Year and the Total Value of all **Indigenous** Raw Materials, Spare Parts and Components similarly consumed and the Percentage of each to the Total Consumption.

(d) Amount remitted during the year in Foreign Currencies on account of **Dividends** with a specific mention of the total number of Non-Resident. Shareholders, the Total Number of Shares held by them on which the Dividends were due and the year to which the Dividends related.

(e) Earnings in Foreign Exchange classified under the following heads, namely:

1. Export of Goods calculated on FOB Basis
2. Royalty, Know-how, Professional and Consultation Fees
3. Interest and Dividend
4. Other Income, indicating the nature thereof.

Note: Broad heads shall be decided taking into account the concept of **Materiality** and **Presentation of True and Fair View** of Financial Statements.